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EXCERPTS FROM THE TESTIMONY

THE HOLDING COMPANY

D. C. BARNES

Direct Examination

[R. p. 3968] A. The subsidiary companies of Engineers Public Service Company or their predecessors have been supervised by a central supervisory organization through several generations of executives, first under the supervision of Stone & Webster Management Division and later under its successor, Stone & Webster Service Corporation, and since May, 1931 under the mutual service company, Engineers Public Service Company, Inc. The dates when such supervision began for each of the companies or their predecessors are as follows:

Savannah Electric and Power Company	1901
El Paso Electric Company	1901
Baton Rouge Bus Company	1907
Gulf States Utilities Company	1907
Virginia Electric and Power Company	1925

[R. p. 3969] As a result, the present local organizations of these companies have been selected and trained for that method of operation and, while they are exceptionally competent and well equipped for that character of operation, none of them have had the training or experience required to qualify them to undertake the task of operating their properties without the supervision of competent and trained executives and experts selected because of their ability and judgment and who have had a breadth of experience in financial, operating, accounting and construction matters not available to men in the local properties. The present supervisory personnel of the mutual service company, each an expert in his respective line, were selected carefully from a large group of men who had been associated in the supervision of public utilities for many years.

THE HOLDING COMPANY (Cont'd)

Through their services the mutual service company assures to its associated companies economical financing, the benefit of purchasing in large quantities, proper and systematic corporate records, proper and uniform accounting, computation and study of statistics of operation, availability of trained men to fill the needs of the operating companies and for the study and handling of specific problems, and the broad experience and consistent supervision impossible to isolated properties and indispensable to the most successful operation.

[R. p. 3970] Therefore, if the subsidiaries are to be divorced from the present mutual service company and if they are to be operated, developed and financed efficiently, arrangements must be made to strengthen their local organizations.

There are two alternative plans which could be followed to do this:

(1) By the employment of such personnel as will provide the requisite supervision; or

(2) To employ a service organization rendering suitable services of this nature.

* * * * *

[R. p. 4725] Q. Mr. Barnes, you stated that there was a second possible advantage tax-wise in having some holding company in the picture. Will you briefly develop this point? A. At the present time a consolidated return for determination of excess profits taxes is filed including Virginia Electric and Power Company and Engineers Public Service Company. This will effect a saving in Federal taxes to Virginia on the basis of 1941 earnings of some $72,000 annually. If, as the President has recommended, Congress eliminates the [R. p. 4726] alternative in the present tax bill which permits the use of the average earnings base and thus limits exemption to that determined by the use of invested

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THE HOLDING COMPANY (Cont'd)

capital, such a consolidated return would save approximately $425,000 for Virginia Electric and Power Company. At the present time Engineers has an investment of over $34,000,000 in Puget Sound Power & Light Company. If Puget Sound Power & Light Company is sold the difference between this amount and the proceeds from such a sale would increase correspondingly the amount of the allowed invested capital in the consolidated excess profits tax return. For each million dollars of such increase in invested capital a net saving in Federal taxes of $29,000 would be realized. It is, therefore, apparent that whether or not the optional use of the average earnings base for determination of excess profits tax liability is eliminated, and even with the most optimistic estimate of realization from the sale of its investment in Puget Sound Power & Light Company, the increase in the invested capital base resulting from such a sale will be such that a further very substantial saving will be realized through Engineers for Virginia in its excess profits tax liability. I want to point out that a utility earning no more than a fair return may be subject to a substantial so-called excess profits tax. No fair comparison can be made between invested capital under the Revenue Act and the rate base. For example, invested capital gives [R. p. 4727] recognition to only 50 percent of the investment represented by debt. Furthermore, the excess profits tax is in no sense a tax on excess profits for it is applied to the taxable income before deduction of normal Federal income tax.

In the alternative if Engineers retains Gulf States Utilities Company and El Paso Electric Company, similar substantial excess profits tax savings could be realized through consolidated returns if the voting preferred stock of Gulf States Utilities Company were refunded with non-voting securities. It is apparent, therefore, that these tax advantages are substantial, and deserve recognition in considering any plan for the disposition of these properties.

* * * * *

THE HOLDING COMPANY (Cont'd)

D. C. BARNES

Cross Examination

[R. p. 4552] Q. Do you think that if Virginia Electric and Power Company were an independent company that Mr. Holtzclaw, a president at $20,000 a year, could not be obtained who would not be qualified? A. No, I do not think, if Virginia were an independent company, it could provide the degree of supervision that it should have by the employment of such an executive.

Q. You believe, do you, that Mr. Holtzclaw has extensive experience in public utility operation? A. Yes, he has, under the supervision of a service organization.

Q. I do not quite understand that, Mr. Barnes. You say, he does have extensive experience under the supervision of a service organization? A. My statement was that Mr. Holtzclaw has had extensive experience in public utility operations under expert supervision.

Q. Well, he has had wide public utility experience? A. In properties which were supervised by a service [R. p. 4553] organization.

Q. In other words, if I state your mind correctly, it is that all the executives of the companies in the Engineers system have, from the inception, operated under supervision from New York, so that none of them would be qualified to operate the companies on their own? A. That is correct.

Q. And that is largely because they have not been given the opportunity, would you say, to assume the responsibility which is at present referred to New York? A. That is the fundamental reason; they must first have the opportunity, and when they have the opportunity, they shall demonstrate their ability to perform.

Q. You do not think that Mr. Holtzclaw had demonstrated his ability to perform adequately so as to be qualified for the presidency, or be qualified to operate Virginia Elec-

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THE HOLDING COMPANY (Cont'd)

tric and Power Company, if independent? A. I do not think he has ever had the opportunity to demonstrate whether he has such ability or not.

Q. And likewise, Mr. Montell Smith, vice-president of Virginia Electric and Power Company, has had very wide experience in the operating of public utility companies? A. He has, under the supervision of a service organization.

Q. The same applies for Mr. Throckmorton and Mr. Jones, [R. p. 4554] vice-president of Virginia? A. That is correct.

Q. Who is Mr. Joseph Chase? A. Mr. Joseph Chase is a vice-president of Virginia Electric and Power Company stationed at Roanoke Rapids, North Carolina, and in charge of the operations of the company in that area.

Q. In charge of the North Carolina division? A. Of the North Carolina division.

Q. The same applies to Mr. Chase, that is, he is likewise— A. (Interposing) The same applies to Mr. Chase, he is thoroughly competent for the work he is doing.

Q. Do you believe it will be advisable—I believe you previously testified—to have supervision over all these executives with their widespread experience, if Virginia were independent?

The Witness: Read the question.

(Whereupon, the pending question was read by the reporter.)

The Witness: The question sounds a little involved to me, but I testified that if Virginia Electric and Power Company were to be an independent company, I think it would be advisable to either reinforce the Virginia organization, or to employ a service organization.

Q. In other words, to reinforce the local staff to [R. p. 4555] supervise the present executive staff of Virginia? A. That is correct.

Q. And why would it not be advisable to have a superstructure or super-staff over the reinforced staff of Vir-

THE HOLDING COMPANY (Cont'd)

ginia Electric and Power Company to supervise this supervisory staff? A. I do not know why we should not have a President over the President of the United States, if that line of logic is to be pursued.

Q. Well, exactly, Mr. Barnes, what in your opinion would an executive with broad utility experience do with respect to the operations of Virginia Electric and Power Company which Mr. Holtzclaw, Mr. Montell Smith, Mr. Throckmorton, and Mr. Jones and Mr. Chase would not be qualified to do? A. He would do a great many things they are not qualified to do. He and the staff which we have proposed, would provide the services which are now being provided by the mutual service company, which services none of the existing staff organization of Virginia Electric and Power Company are qualified to undertake.

Q. Well, exactly what, with respect to the operations of Virginia Electric and Power Company, if it were independent, would— A. (Interposing) I introduced in my direct testimony Engineers' Exhibit No. 229, which outlines in considerable [R. p. 4556] detail the nature of the services furnished by the mutual service company. It is service of that character that this reinforced staff would provide and which the existing staff of Virginia Electric and Power Company are not at present equipped properly to provide.

Q. The mutual service company obtains the expert executives from the operating companies, does it not? A. That is correct.

Q. When they reach the necessary point of efficiency in the operations of various subsidiaries of Engineers, and an opening exists in the mutual service company, they are taken up into the mutual service company? A. That has been the history of the mutual service organization.

Q. And are the large executive staffs— A. (Interposing) Large, did you say?

Q. My question is, are the large executive staffs in the operating utility companies of the Engineers system any

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THE HOLDING COMPANY (Cont'd)

more qualified because they happen to be in New York than if they were in Richmond or Savannah or Baton Rouge? A. The executive officers of the mutual service company in New York are men who, by their work in the field, have demonstrated good judgment, intimate knowledge of the business,—who have had broad experience and been successful in operating public utility companies; they have been brought in to the [R. p. 4557] central organization as a result of that trying out or distillation process in which the best are selected from those available, and, in New York, had a broad experience over a long period of time which has given them the training and ability to make decisions which men in the field without that experience or ability or judgment are not competent to undertake.

Q. The men in the field, however, who are the executives of the various subsidiaries of Engineers Public Service Company, are thoroughly qualified as utilities operators? A. They are thoroughly qualified to operate utilities under supervision of the character which they now have.

Q. Mr. Barnes, is it not quite a fair thing to say that some day Mr. Holtzclaw will be promoted to the ranks of the mutual service company? A. I think that question presupposes the continuance of the mutual service company.

Q. I was making that assumption. A. It seems to me that in view of the circumstances that exist, that is not a reasonable assumption.

Q. Let us assume, for the purpose of my question, that the service company is going to continue to exist. Is Mr. Holtzclaw the type of executive who, in the normal course of events, would eventually be elevated to the service company? [R. p. 4558] A. Yes, I think if the mutual service company were to continue, and if we needed additional men in the mutual service organization, Mr. Holtzclaw would be brought in as one of the staff, but he would not be given, in the beginning, until he had accumulated a substantial

amount of experience, a final voice in the making of decisions of policy and other important questions.

Q. Your own training was in an operating company, was it not? A. It was.

Q. You were operating head of the Puget Sound Power and Light Company, were you not? A. I was the head of the Central Division of Puget Sound Power and Light Company.

Q. What office did you have? A. The office was that of manager of Puget Sound Power and Light Company, Central Division,—at the time I came back to Boston, at that time, I was made a vice-president of Puget Sound Power and Light Company.

Q. And then you were promoted to the service company? A. That was the time when I was promoted to the service company,—that was in 1924.

Q. And you were able to take some advisory duties on, at that time? A. I was given a position which might be described as [R. p. 4559] that of sponsor; about a year after I came back to the office—my first year at the Boston office, in that year I was assistant to a sponsor. The following year, I was made a sponsor, although that was not the title used at that time, but that describes the nature of the work.

Q. Did you experience any difficulty in working into your new duties? A. I had a long course of training, had over me men who had had long experience in supervising the properties,—had an opportunity to take up problems with them and get their advice over a period of 13 years,—I functioned as an assistant or vice-president in the supervising of operations of utility properties and financing.

Q. Has not Mr. Holtzclaw had long experience with executives of the service company? A. No, he has not been an executive, he has been a director in the service company, but he has not been an executive.

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D. C. Barnes—Cross Examination (Cont'd)

THE HOLDING COMPANY (Cont'd)

Q. I understand that, but has he not had many contacts with Mr. Charles Kellogg, Mr. Cool, and the other top men in the service company, bearing in mind of course that Mr. Kellogg is now resigned? A. As the president of one of the subsidiary companies of Engineers Public Service Company, he has of course conferred with the men whom you mentioned, but he has not had [R. p. 4560] training in the supervision of operations of a number of utility companies.

Q. Well, how does the operating company executive acquire this proficiency? A. Acquire what?

Q. This proficiency of supervision. A. In our organization, they acquire it by being brought in to the supervisory headquarters and given more and more responsibility as their ability and judgment and experience warrant it.

* * * * *

L. F. YETMAN

Cross Examination

[R. p. 2989]

Q. Where are the reports to the Federal and State agencies, of your company, prepared? A. In El Paso.

Q. By the accountants of your company? A. Yes, of my department.

Q. And then they are sent to Stone & Webster Service Corporation for checking? A. No, sir.

Q. What happens to them then? [R. p. 2990] A. Those that we feel need review to determine that they comply with all the rules and regulations applying to the construction or preparation of the report,—they are sent to mutual service company's treasurer's department for review and any comments before actually filing them.

Q. Did the mutual service company make any changes in the report you sent to them covering the report to the

Federal Power Commission for 1940? A. No. As I recall, of course, there were some few comments regarding the interpretation of certain questions, but our experience in El Paso now, having had the experience of preparing those reports since 1938, the first one of course being in 1938,—we are able to pretty much prepare the information as it is designed and called for in the report.

Q. Did you or your office in El Paso prepare the information with respect to El Paso Electric Company of Texas, contained in the annual supplement to the registration statement with this Commission? A. The El Paso office furnished to the treasurer's office practically all of the material necessary to the preparation of it.

Q. Where are the tax returns for your company prepared? A. They are prepared in the El Paso office.

Q. And then they are sent to the mutual service company? A. As I said in my testimony, they are sent to the [R. p. 2991] treasurer's office for review, to make certain that they are interpreting the Internal Revenue Act and any amendments thereto.

Q. Were there any changes made in the tax returns of your company for the year 1940 by the service company,—by the mutual service company? A. I think there were some suggested changes, I do not recall,—I would have to review our correspondence.

Q. Do you know if you proposed the payment of any different amount in taxes, in your statement as sent to the mutual service company, than is shown in the tax return as filed with the Internal Revenue Department? A. I do not recall that there was any change in the amount as we had computed it, and as checked by the treasurer's department.

Q. Does Stone & Webster Service Corporation render tax services? A. I believe they do.

Q. They do not render any tax services to your company, do they? A. No, sir.

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L. F. Yetman—Cross Examination (Cont'd)

THE HOLDING COMPANY (Cont'd)

Q. Why do you not employ them for that purpose? A. Because we get our tax service through the experts in the employ of the mutual service company.

Q. And also because you feel that your local staff is [R. p. 2992] adequately competent to prepare the tax return? A. Yes, with the advice and counsel of the tax experts in the mutual service company.

Q. Do you recall any year during the past three years in which the company, in preparing its tax return, proposed to pay a different amount of taxes than the amount that was paid? A. Within the last three years? Yes, I would say,—we were not quite positive of the treatment of certain abandonment losses arising from the discontinuance of certain street car lines, and the treasurer's department tax men advised us on the treatment of that particular kind of item.

* * * * *

VIRGINIA GAS

J. V. MITCHELL

Cross Examination

[R. p. 350] Q. It is correct, is it not, Mr. Mitchell, that the company's surplus is not earmarked as to whether it was [R. p. 351] derived from electric or transportation department? A. That is true.

Q. There is no means of telling, under the company's method of bookkeeping, as to whether or not there was or was not a transportation surplus at any given time? A. That is true.

Q. It is also true, to your knowledge, is it not, that electric rates are based in part on net income and on the net book value of the electric property? A. Yes, sir.

Q. And likewise the transportation rates are based upon the transportation net income and transportation net book value of the transportation property? A. Yes, sir.

VIRGINIA GAS (Cont'd)

Q. And it is also correct that there is no method under the company's present method of bookkeeping of determining a net income from electric operations and the net income from the transportation operations?

The Witness: Will you repeat that question, please?

(Whereupon the pending question, as above recorded, was read by the reporter.)

A. Not without making certain provisions for charges, separation of charges, shown on the books.

Q. But there is no separation of certain of the important charges that the company makes—that is, separation [R. p. 352] between departments? A. That is right.

Q. So that, under the method of bookkeeping employed by the company, the amount of the departmental net income can not be determined? A. Not without making some separation of such charges for the particular purpose for which the net income is needed.

* * * * *

[R. p. 347] Q. But there wasn't that much depreciation charged, in fact, during 1938, is that correct, so that there was not a deficit in 1938 in the railway operation? A. The provision made in 1938 to the retirement reserve [R. p. 348] was made for the company as a whole, and was not separated between departments, so, in the absence of any separation between departments, of the appropriation to retirement reserve, which was made in 1938, I can't say what the balance after depreciation might have been.

* * * * *

[R. p. 4015] Q. For the combination electric customers in Norfolk, I am sorry, and 34 employees for the gas customers in Norfolk, and 30 employees for the single service electric customers in Norfolk and the electric customers in Portsmouth, or a total of 98, as against 90 employees presently employed to carry out that work. A. On the assump-

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VIRGINIA GAS (Cont'd)

tion that it would require 34 employees to do the customers accounting work for approximately 30,000 customers, as shown in Exhibit 221, I based my estimates, all of my estimates, on the figures in that statement. On that basis, it would take 34 employees to do the accounting work for the 30,000 combination electric customers in Norfolk. It would take 34 employees to do the customers accounting work for the gas combination customers in Norfolk; and it would take approximately 30 employees, at least 30 employees, to do the customers accounting work for the single service electric customers in Norfolk and in Portsmouth.

Q. Now, if the gas department were independent, it [R. p. 4016] would take more employees to do the customers accounting and collecting work for the electric and gas customers accounting than is presently required? A. That is right.

Q. What would be the nature of the work of the additional employees? Would it be largely clerical? A. It would involve practically all phases of the clerical work; it would involve the reading of meters, the collection of accounts, the taking care of service contracts, and so on.

Q. The average compensation to that type of employee is about $1,500 a year? A. It varies for the different classes of work.

Q. Would not $1,500 a year for such additional employees be a pretty fair estimate? A. It may be. I do not have any figures on the average annual salary for the entire group of customers accounting department employees in the Norfolk and Portsmouth districts.

Q. Well, are not the salaries shown on page 2 of Engineers Exhibit 221 about the same salaries paid to the particular classes of employees shown thereon as the company presently pays? A. Yes.

* * * * *

[R. p. 4028] Q. You think that it would require two cashiers for the independent gas company; is that what I under-

VIRGINIA GAS (Cont'd)

stand? A. I said I did not believe that it could be done with any less than two.

Q. And you believe that there would be enough work to keep two cashiers busy, with practically no time available by such cashiers to do anything else? A. Well, they would have to do certain clerical work involved in connection with the collection of accounts, of course.

Q. Then, in your opinion, an independent gas company would require two cashiers who could also do some of that other clerical work? A. An independent company would require, I should say, two or three cashiers to do the work in connection with collecting customers accounts and the clerical work that is [R. p. 4029] strictly connected with the cashiers' work.

Q. You do not think that the independent gas company could get along with one cashier? A. I do not think so.

Q. You think they could get along with two? A. They could not get along with any less than two, I do not believe.

Q. But you do believe they could get along with two? A. They might be able to get along with two. Of course, there would undoubtedly be a certain amount of readjustment in the work. It would have to be fitted into the time.

* * * * *

[R. p. 4044] Q. What is the amount of the customers' billing and accounting expense for just the combination electric customers in Norfolk? A. I don't believe I have that figure.

Q. It would be $9,700, wouldn't it, the same amount as for the gas customers? A. Will you repeat the question, please?

(The last question was read.)

A. Following through the reasoning the idea that if it costs $811.89 to take care of the customers' billing and accounting work for a certain number of gas customers, it would take the same amount of money to take care of the accounting work for the same number of electric combination customers.

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VIRGINIA GAS (Cont'd)

Q. Then, in other words, it would cost $19,400 for the customers' billing and accounting work for the electric and gas customers in Norfolk, who are combination customers, is that right? [R. p. 4045] A. By multiplying the $9,700 amount shown on Exhibit 221, which applies to gas customers only — multiplying that by two — it would give $19,400.

Q. Well, then, why should the cost for customers' billing and accounting for just the gas operation, if an independent company, cost more than customers' billing and accounting for both combination electric and gas customers in Norfolk? A. Because you do lose some efficiency with small volume.

Q. How much efficiency do you lose? A. I couldn't say.

Q. You don't lose more than 100 per cent efficiency, do you? A. No, sir.

* * * * *

[R. p. 4053] Q. At present the supervisor of accounting and collecting in Norfolk is in charge of both gas customers' accounting and collecting in Norfolk and electric customers' accounting and collecting in Norfolk and Portsmouth? A. That is right.

Q. And he devotes part of his time to gas as well as electric, and part of his time to Norfolk as well as Portsmouth? A. That is right.

Q. And if the Gas Department were an independent company, then the supervisor of customers' accounting and collecting for the Gas Department would have a more limited [R. p. 4054] sphere of activities than the present supervisor? A. That is true.

Q. He would have less to do than the present customers' accounting and collecting supervisor? A. He would have less accounts to supervise.

Q. And likewise the credit manager would have less to do? A. Yes.

VIRGINIA GAS (Cont'd)

Q. And if the independent Gas Department were economically operated as an independent company, it might be very advisable to consolidate these two positions into one? A. It might be.

Q. Mr. Mitchell, did you take part in any discussion with officers of your company in April or May of this year in which it was decided that Lybrand, Ross Bros. & Montgomery should be requested to make a study as to the interdepartmental allocation of expense? A. Yes, I did.

Q. Why was Lybrand requested to make that study? A. Lybrand, Ross Bros. & Montgomery was requested to make that study because of this particular hearing.

Q. And but for these proceedings, the company would have continued with the old method of allocation between departments? [R. p. 4055] A. Very likely.

Q. What was it that made you feel it necessary to have Lybrand make this study? A. As I recall, certain exhibits that were submitted by the company in this case, and in the gas status case, were questioned in so far as separation of expenses between departments was concerned. In order that there might be placed in the record exhibits which would show a correct separation of such expenses and other charges between departments, it was decided that an independent certified public accounting firm should be employed to make the necessary study.

Q. Because you felt that your former system of allocation might be wrong? A. We did not feel that it was substantially wrong.

Q. Then why was the study made? A. Because of the attitude, as I recall, of the counsel for the Commission.

Q. You recommended the adoption of the method of allocation proposed by Mr. Taylor? A. Mr. Taylor recommended it.

Q. You likewise favored its adoption, did you not? A. I think the adoption of it should be made, yes.

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VIRGINIA GAS (Cont'd)

Q. Why do you believe that? A. Because we feel now, after having had the benefit [R. p. 4056] of Mr. Taylor's organization having made the study, that his recommendation will bring about a separation of charges between departments that is as reasonably accurate as can be had.

Q. In other words, you think it is a better method of allocation than the method that was previously employed? A. I think so, yes.

Q. And this new method of allocating expenses will not be any more costly; that is, it won't take up any more time of the accounting staff, than the old method, will it? A. I think it will take up some little additional time, yes.

Q. Well, about how much time would you say; how much additional time would you say it would take the accountants of the company to break up and allocate the expense between the departments as proposed by Mr. Taylor? A. I couldn't even guess.

Q. Would you say it would take the time of perhaps one or two or three more accountants? A. I don't know, because you just cannot see the places where it takes the additional time.

Q. Do you think that it might be necessary to increase your staff because of the work in connection with the allocation of expense as proposed by Mr. Taylor? [R. p. 4057] A. Not directly, no.

Q. Indirectly, it might be necessary? A. To a very small extent.

Q. Do you have any plans for checking on the allocations from time to time by time studies or otherwise? A. Oh, yes.

Q. How often do you plan that? A. Mr. Taylor made recommendations that various checks be made from time to time. Some of the checks will be made on a three-months basis; some of the others will not be made in periods of less than a year.

VIRGINIA GAS (Cont'd)

Q. Such studies will be made by the company? A. That is the present thought now.

* * * * *

[R. p. 4060] Q. I see. Now, of, say, about forty-five people that I now understand work on the allocation of expense, could you generally estimate how much time they spend—about one per cent of their time? A. I just don't know.

Q. You are thoroughly familiar with their work? A. Yes, but that is just one task out of many, and it cannot be separated from their other work.

Q. They do devote some time to it? A. Oh, they are bound to, because it is part of their work.

[R. p. 4061] Q. Has the adoption of the Taylor method of allocating expenses increased the amount of time of these employees? A. I think it has, some.

* * * * *

[R. p. 5035] Q. It is true, is it not, that the gas department is housed in a building that is owned by the Virginia Electric and Power Company in Norfolk? A. The main office of the gas department is housed in the [R. p. 5036] general office building located at Norfolk.

Q. Is any rent charged? A. There is no rent charged for the space used. There is a charge made against the department in connection with the costs of operating that building.

Q. Is that charge of cost of operation also made to the electric department? A. Yes, sir.

Q. How is that allocated? A. That is allocated on a general split of expense between departments of the company in the Norfolk division.

Q. On what basis is the charge made, the number of square feet occupied? A. No, it is not made on the basis of the square feet occupied by the gas department. It is a percentage basis which is determined from the net operating revenues of the various departments, compared to the total.

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VIRGINIA GAS (Cont'd)

[R. p. 5044] Q. Are billing and accounting expenses a direct charge to the gas department and to the electric department, or are they based on an estimate? A. Some of them are based on an allocation between departments.

Q. The allocation is based on an estimate? A. Yes, sir. Let me qualify that if you will, please. It is based on an allocation of percentages determined from using the net operating net revenues of departments, as compared to the net operating revenues for the company.

Q. It is true, is it not, Mr. Mitchell, that the net operating revenues of each department have no relationship to the time devoted by persons who are billing and accounting, as [R. p. 5045] to gas customers and as to the time devoted for such work as to electric customers? A. Yes, sir.

* * * * *

J. V. MITCHELL

Redirect Examination

[R. p. 5049] Q. How is the expense of operating those jointly-used facilities, that you have just described, allocated as between Electric and Gas Departments? [R. p. 5050] A. The joint expenses are allocated between Electric and Gas Departments on the basis of net revenues.

Q. How about automobiles? A. In the case of pool automobiles, the expenses are allocated between the Electric and Gas Departments on the basis of the mileage used by each department.

Q. Now with that exception, what is the percentage that is applied or applicable to Gas? A. The percentage during the year 1939, I believe, that was applied to the Gas Department, was 12 percent.

Q. In other words, that was the ratio of net operating revenue in the Gas Department to the total? A. That is right.

VIRGINIA GAS (Cont'd)

J. V. MITCHELL

Recross Examination

Q. Mr. Mitchell, how was that 12 percent arrived at? A. The 12 percent was arrived at by comparing the net revenue of the Gas Department to the total net revenue of all departments in the Norfolk Division.

Q. When you speak of net revenue, do you mean the balance remaining after operating expenses are deducted from operating revenues? A. Yes, sir, I do.

Q. Are not expenses for customers' accounting and collecting, operating expenses? [R. p. 5051] A. Yes, sir.

Q. And sales promotion? A. Yes, sir.

Q. And administrative and general? A. Yes, sir.

Q. Then how can the net be determined before the amount of those items of operating expenses is determined? A. I should have said that the ratios are determined at the beginning of the year, based on the figures for the preceding year.

Q. Well, when did this method of allocation start? A. This method of allocation has been in effect for several years. I am not certain as to the exact year when it started.

Q. What was the method employed before this method of allocation was employed? A. The method employed previously was based on the gross revenues.

Q. Why was that method discontinued? A. Because it was thought that by using the ratios based on the net revenues, a fairer distribution of expenses between departments would be obtained.

* * * * *

[R. p. 5063] Q. Your answers this morning, Mr. Mitchell, do not change the fact that the allocation of the items of expenses shown in Commission's Exhibit No. 3 as to customers' accounting and collecting, sales promotion, advertising, ad-

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ministrative and general expense as allocated between the Electric Department and Gas Department bear no relationship between the time devoted by the persons who carry on the activities that make up those expenses, is that not true? A. It is true in regard to those expenses which are allocated on the basis of net.

Q. Why should it make any difference in regard to the expenses that are allocated on the gross basis? It still has no relationship to the time devoted by the persons employed to [R. p. 5064] carry on the duties that make up those expenses, is that true? A. It has no relation to the time devoted by the individuals, but I do believe that a gross allocation basis has a bearing on the distribution of expenses between the Departments.

Q. It has a bearing upon the way you have allocated the expenses? A. Yes, sir.

Q. But it has no bearing upon the fact that the expenses are not allocated upon a basis that represents the proportion of time devoted by persons in the various departments to the Gas activities as against the Electric activities, is that true? A. Not on the basis of the proportion of time, no.

Q. Is it not true that if an allocation were made on the basis of the time devoted by the persons who carry on those activities, it would be the most accurate allocation of the actual expenses that could be arrived at? A. I just cannot say, because it is an impossibility to determine the actual time which a man devotes on the Gas Department operations when his entire time is devoted to both the Electric and Gas.

Q. If his entire time is devoted to Electric and Gas, and all during the time that he is employed he is either working on activities for the Electric Department or the Gas Department, then would not a fair allocation be to divide up [R. p. 5065] the time and expenses equally between the Elec-

tric Department and Gas Department? A. Well, he is either working on matters pertaining to the Electric Department or the Gas Department, or matters that are involved with both the Electric and Gas Departments.

Q. If he kept a time schedule showing the amount of time he was spending for the Electric Department and the amount of time he was devoting to the Gas Department, and his salary were allocated proportionately between the Electric Department and Gas Department in relation to such time, then aside from the amount of time that he was devoting to both departments, there would be a proper allocation, is that not right? A. I think it would still involve an element of estimating.

Q. But it would be a much more accurate estimate than an estimate based upon net revenues, would it not? A. I just can not say; I do not know.

Q. Well, it would come much closer to representing the actual expenses than an arbitrary allocation based upon net revenues, would it not? A. It would depend entirely on the estimate of the time which is concerned with working on both electric and gas matters at the same time.

* * * * *

[R. p. 5073] Q. And if, in a given year, there were no net operating revenues in the Gas Department, then none of Mr. Holtzclaw's or Mr. Throckmorton's salary would be allocated to the Gas [R. p. 5074] Department, is that correct? A. That is right.

Q. Do you believe that is a fair method of allocation? A. Not in a condition like that.

Q. Well, if the Gas Department's net operating revenues were a very small amount, it would likewise be unfair, would it not? A. Well, where you have a condition where the Department does not have any net after operating expenses, or a very small percentage after operating expenses, why, then it would not be a fair basis.

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VIRGINIA GAS (Cont'd)

Q. Then we come back to the question that this basis in fact has no relationship to the actual expenses. A. It has no direct relationship to the allocation of expenses on the net basis.

* * * * *

C. B. TAYLOR

Cross Examination

[R. p. 963] Q. If the charges in the past between departments of Virginia Electric and Power Company have been on cost, then isn't it true there would not be a necessity for you to come here today and propose any adjustments in these expenses? A. Well, a number of the adjustments that have been made here have not been made for the purpose of changing from some other basis to cost but have been made for the basis of setting up charges that have not been made at all in the past.

Q. Then to the extent to which they have not been made at all, there has not been a proper allocation of expenses at cost? A. To the extent that they have not been made at all, that is so.

* * * * *

[R. p. 964] Q. Were you the auditors of the company at about the end of 1933 when the company changed the method of allocating certain expenses from a gross basis to a net operating revenue basis? A. Yes, my firm were the auditors at that time.

Q. And you reviewed the audit? A. I am not absolutely sure whether I reviewed it or whether it was one of my partners at that time.

Q. Did you or your firm consult in regard to that change at the end of 1933 in the allocation of certain expenses of the company from a gross basis to a net operating revenue basis? A. I did not, myself.

Q. Did the firm? A. Not that I know of. I think it is most unlikely that the firm would have had that question to

VIRGINIA GAS (Cont'd)

concern them because the firm was not interested at that time in an allocation of expenses between departments. They were looking solely at the income of the corporation as a whole.

Q. But in auditing the books of the company, are you not concerned with the income of the various departments? A. To a certain extent, yes.

Q. Did you know the reason or do you know the reason for [R. p. 965] the change in 1933 in the method of allocating expenses of the company? A. I only know the reason as it was explained to me in the last week or so during this investigation which I have been making. I was told that the change was made because it was felt that the apportionment of expenses on a net revenue basis more accurately reflected the activities of each department than did the apportionment on a gross basis and, for that reason, it was changed.

Q. Do you agree with that reason? A. I cannot say that I agree with it or I do not agree with it because I think the only way in which you can determine what would be a fair method of apportionment would be to make an actual time study, say for a period of a month, in each of these departments to find out just how the services are rendered to the various departments.

Now, my own personal feeling is that if such a study were made, it possibly would result in something between a net revenue basis and a gross revenue basis. In other words, I think that the gross revenue basis perhaps falls a little unfairly on the transportation department and a little less heavily than it might on the electric department but that is, as I say, strictly surmise on my part.

* * * * *

[R. p. 3463] Q. Now, how did you arrive at the figure of three fourths or 75 percent as the basis for your weighting, or the basis for your statement, if it is correct, that because of the combination service only three fourths of the time

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C. B. Taylor—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

that would otherwise be required is required in the performance of the services? A. That figure was arrived at by discussion with the comptroller of the company and the manager of the customers [R. p. 3464] accounting department and an inspection of the various records which are kept which show these combination services.

Q. In other words, it was based upon a review of the nature of the work performed by employees who perform this combination service? A. That is practically the only way you could arrive at it.

* * * * *

R. J. THROCKMORTON

Cross Examination

[R. p. 4121] Q. And if the amount of customers' billing and accounting expense to combination service customers amounts to $19,400, or twice the $9,700 shown on page 1 of Engineers' Exhibit 221, then how do you justify or reconcile that with your estimate of $19,800 to the gas department, if independent? A. Because this figure of $9,700 is the figure as set up in the Taylor report as the amount properly chargeable against the gas department.

Q. It would not be chargeable against the gas department? A. It is charged against the gas department.

Q. Well, how does that reconcile the two figures? A. Because you are going to need—what I mean is, you have your joint use of personnel, joint use of equipment, and all of those things come into this additional expense.

Q. My point is, Mr. Throckmorton, that if you have a certain number of people each of which do two things, such [R. p. 4122] as a meter reader reading electric and gas meters—A. Yes.

Q. (Continuing)—and a collector collecting electric and gas bills, and the cost of those people doing that amounts

VIRGINIA GAS (Cont'd)

to $19,400 for customers' billing and accounting; and then you tell those people that they do not have to collect electric bills or read electric meters, and so forth: Then, how do you explain that the expense for only doing one thing, instead of two, would increase $400? A. Because they have to go to the same location to read the meter, anyway,—they have to go to the same location to collect from the individual customers, and they have to send out individual bills rather than the duplicate bills.

Q. And the cost of sending out the bills and so forth now, comes to $19,400? A. It is a smaller operation.

Q. The combination electric and gas? A. I mean, it is a smaller operation as an independent gas company.

Q. My question, the one I was coming to, Mr. Throckmorton, is—you have those people going out and doing these things at a cost of $9,700 charged to the gas department and $9,700 charged to the electric department, or $19,400 for the combination service, for customers' billing and accounting, and then you come along and—[R. p. 4123] A. (Interposing) I have not testified to that, because I do not think that is a fact.

Q. But if that is a fact—A. (Interposing) I cannot assume that.

Q. I am asking you to assume it on the basis of Mr. Mitchell's testimony, and if it is a fact—and at this point I might ask why it would not be a fact; do you know? A. No, I am not in a position to say.

Q. All right, then,—if it is a fact that it costs $19,400 for customers' billing and accounting for electric and gas customers, and then you have a smaller operation and you tell these people that they do not have to read meters or do anything in regard to electric customers, just drop their work on that and do everything they were previously doing on the gas customers,—then, can you offer any reasonable explanation as to why the expense of that should increase $400? A. This estimate of $19,800 was made up by con-

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VIRGINIA GAS (Cont'd)

sultation with the department heads and with men who had long experience in public utility operations, and we have set up an organization that we think will give the same service that the customers are getting now, and we figure that the cost of customers' billing and accounting will be $19,800.

Q. But you cannot reconcile that increase of expense of $400 over the expense of $19,400 to do the same thing for the electric and gas customers, can you? [R. p. 4124] A. I would have to make quite an analysis of it.

Q. What kind of an analysis could you make? A. I do not know.

Q. You mean that at present you do not know how you can reconcile the two figures? A. The only thing I can say is that we set up an organization to render the same type of service to customers in this accounting and collecting, and our estimate for the cost of doing that work is $19,800 a year.

Q. My question, however, Mr. Throckmorton, was, could you reconcile the two figures presented before you? A. My answer is that I made no comparison and we set up an independent organization and that was the cost of operating an independent company.

Q. You said you made no comparison? A. No; we set up an organization with all of the experience that the department heads and the executives have had, and we set up an organization that we thought would provide the same type of service now being provided.

Q. And you did not compare that with the present expense or anything else,—you just drew from your experience and imagination? A. We did not use imagination, we had experience.

Q. You drew from your experience and made this estimate but did not make a comparison with the present expense, [R. p. 4125] is that right? A. The present expenses are prorated.

VIRGINIA GAS (Cont'd)

Q. I am aware of the fact that they are prorated, Mr. Throckmorton; I am asking you now if you made a comparison with the present expenses. A. We could not make a comparison of straight expense with prorated expense, very well.

Q. But the total of the prorated expenses to gas and electric departments should be more than the expense to the gas department, if independent, should it not?

The Witness: Repeat the question, please.

(Whereupon, the pending question was read by the reporter.)

The Witness: Not according to my estimate.

By Mr. Fischgrund:

Q. In other words, you think that it should cost the gas department more for customers' accounting and collecting than is expended for customers' accounting and collecting for both the gas and electric departments, for the combined service customers? A. I testified that our estimate of the cost of customers' billing and collecting under the independent set-up would be $19,800.

Mr. Fischgrund: Read that question, please.

(Whereupon, the question was read by the reporter, as follows:)

[R. p. 4126] "Q. In other words, you think that it should cost the gas department more for customers' accounting and collecting than is expended for customers' accounting and collecting for both the gas and electric departments, for the combined service customers?"

The Witness: What did I say? Repeat my answer, please.

(Whereupon, the answer was read, as follows:)

"A. I testified that our estimate of the cost of customers' billing and collecting under the independent set-up would be $19,800."

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R. J. Throckmorton—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

By Mr. Fischgrund:

Q. Would you now answer the question, Mr. Throckmorton?

The Witness: Read the question again, now?

(Whereupon, the question was again read by the reporter.)

The Witness: I would not think, normally, that it would cost more, but under the set-up here, it appears to cost more.

* * * * *

[R. p. 4152] Q. You are a vice president of Virginia Electric & Power Company, in charge of the gas operations, are you not? A. In charge of the Norfolk division.

Q. Which embodies the gas department? A. Yes.

Q. Do you feel that you are entirely qualified for the presidency of the gas department if, an independent company? A. It is a very embarrassing question.

Q. Well, you know that you are. A. I am an operating vice president. I do not know much about the other part of it.

Q. You feel you are qualified to handle the operations of the gas department if it were an independent company, do you not? [R. p. 4153] A. Yes, I think I could.

* * * * *

[R. p. 4154] Q. You are familiar with the testimony, I believe, of Mr. Holtzclaw to the effect that if the gas department were an independent company, it would be advisable to retain Stone & Webster Service Corporation? A. Yes.

Q. Can you explain exactly why it would be necessary to retain that service corporation, that is, exactly what the service corporation would do other than that which is presently obtained by the gas department from outside sources? A. I would rather Mr. Holtzclaw explain that.

Q. I am asking for your opinion on that, your opinion in regard to what it would be necessary for them to do. A. I am not familiar enough with that to know.

VIRGINIA GAS (Cont'd)

Q. You are not familiar with what? A. With the question that you asked.

Q. What is there about the question I asked that you are not familiar with? A. To answer the question you asked. You asked me a question, and I said I am not familiar enough to answer it.

Q. You are familiar with the gas operations? A. Yes, sir.

Q. And you are familiar with what it would take to operate the gas department if an independent company? [R. p. 4155] A. Yes, sir.

Q. And you are familiar with the services presently obtained from Stone & Webster Engineering Corporation? A. Generally, yes.

Q. But you do not know what services, other than those presently obtained from Stone & Webster, it would be advisable for the gas department to have if an independent company? A. Well, it would be the same services we get now from Engineers Public Service.

Q. What are those services? A. Mr. Fischgrund, I am not in a position to give you the detail of what those services are. They service the whole property.

* * * * *

[R. p. 4174] Q. In other words, the executives of the company devote about 5 percent of their time and about 5 percent of their salaries is charged to the gas department. A. According to this report, yes.

Q. Do you believe that they do devote such a small amount of time to the gas department? A. I do, yes.

* * * * *

[R. p. 4175] Q. But much of the time that they do devote to the gas department consists of keeping abreast of the gas operations? A. Checking the operations and seeing how the property is going; discussing possible expansions. It does not take very long.

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R. J. Throckmorton—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

Q. How many sales engineers does the company have in Norfolk? A. They have two that devote their entire time to gas, as outside salesmen. Another is outside part of the time and does a lot of clerical work in the office.

Q. Two that devote their entire time to gas? [R. p 4176] A. Yes, sir.

Q. Are they commercial or industrial sales engineers? A. Both.

* * * * *

[R. p. 4179] Q. You observe, Mr. Throckmorton, on the second page of Engineers' Exhibit No. 223, that it is estimated that the advertising expense— A. (Interposing) What page is that?

Q. The second page.

(Continuing)—that advertising expense would increase $2,500 a year if the gas department were an independent company, according to that estimate? A. Yes.

[R. p. 4180] Q. You observe that? A. I do.

Q. Do you know the reason for that, or why, in your opinion, it was necessary for that increase in expense? A. Well, I think they would have to do quite a bit of good-will advertising and additional merchandise advertising and probably could not get as low a rate as they are getting now in the papers, and $300 a month seemed to us to be a rather low figure for advertising.

Q. In other words, you think that the entire amount of the company's advertising, if it was an independent company, would be about $300 a month? A. Of an independent gas company?

Q. Yes. A. Well, I think it would be at least that.

Q. That would be for general sales promotion and also for the sale of appliances? A. Yes.

Q. Do you know the amount charged to the gas department now for a similar type of advertising? A. No, I do not have those figures.

VIRGINIA GAS (Cont'd)

Q. Do you know how much it was during 1940? A. No, I do not.

Q. It was more than $1,000 or $1,100, to your knowledge, was it not? [R. p. 4181] A. I could get that information for you, but I could not say, offhand.

Q. You believe that there would be an increase of $2,500 a year in advertising if the gas department were an independent company? A. Yes, as shown in this statement.

Q. That is on the basis of $1,100 now charged for advertising, subtracting from $3,600 for advertising if the gas department were independent? A. That is based on the comparison with the Taylor report.

Q. Does the $1,100 of advertising include advertising for merchandising and jobbing charged to the gas department? A. That footnote reads that it is adjusted to reflect—

Q. (Interposing) My question was whether or not it includes advertising for merchandising and jobbing. A. It is on a prorated basis.

Q. Does it include it? A. It includes all advertising chargeable to the gas department.

Q. Do you believe that under the present operations the normal advertising expense chargeable to the gas department would not amount to more than $1,100 a year? A. About that, yes.

Q. And how do you reconcile that with page 45 of [R. p. 4182] Engineers' Exhibit 202, which is the Taylor report, which shows that during 1940 advertising charged to merchandising and jobbing, and applicable to the gas department, amounts to $2,565? A. That is based on the Taylor allocation of the gas department's proportion of the total advertising cost.

Q. There was some advertising expenses charged to the gas department in addition to the $2,565 charged to the gas department's merchandising and jobbing operations during 1940, was there not? A. I am not familiar with that, Mr. Fischgrund.

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VIRGINIA GAS (Cont'd)

Q. Well, are you familiar enough with it to know that in your opinion it would require $300 a month advertising for an independent gas company? A. A minimum of that amount, yes.

Q. And you are familiar with it enough to know that there was $2,500 of advertising for the gas department last year? A. Well, I see that from the Taylor report, yes.

Q. And you also know, do you not, that there was about $1,100 in advertising charged to the gas department, itself, and not to merchandising and jobbing operations, during 1940? A. Well, this adjusted figure—is that what you are talking about?

[R. p. 4183] Q. I am using that as the basis, yes. A. According to that exhibit, yes.

Q. And the total of those two figures amounts to about $3,665? A. Yes.

Q. That would be about how much, in your opinion, the gas department paid in advertising last year, would it not? A. Well, I think we could find that out exactly, just what they did pay.

Q. But it is still your opinion that there would be an increased expense for advertising if the gas department were independent, over the amount paid now? A. I did not say an increased expense, I said our estimate was that there would be an expense of at least $300 a month for advertising as an independent company.

Q. And what is the reason for spending that much if only $1,100 is now spent for advertising during a given year? A. Well, we would have to do more advertising than we are doing now.

Q. Why? A. Well, they would have a lot of good-will advertising to do.

Q. That is, until they became established, they would? A. I think so.

R. J. Throckmorton—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

Q. But after they were established as an independent [R. p. 4184] gas company, then what? A. It would be entirely a matter of policy with them.

Q. They may very well return to the same amount of advertising expense as charged to the gas department now? A. I do not think it would get as low as it is now.

Q. Why not? A. They could not carry on as they are now.

Q. In other words, whatever increase there may be because of setting up an independent gas company, in the form of increased expense in advertising, it would be in the form of an non-recurring expense? A. No, I did not say that.

Q. Is that not true? A. I do not think so.

Q. Why not? A. You mean, any increase of $2,500 is a non-recurring expense,—is that what you asked me?

Q. That is right. A. I would not say it is a non-recurring expense; I think it would go on—certainly a large portion of it.

* * * * *

[R. p. 5133] Q. Who is directly in charge of the gas operations? A. R. C. Brooks.

Q. What is his position? A. He is manager of the department.

Q. Is he directly responsible to you? A. Yes, sir.

Q. He devotes all his time to gas operations? A. His entire time.

Q. And he has full authority over the gas operations? A. Yes.

* * * * *

H. V. FABER

Cross Examination

[R. p. 4375] Q. If the gas department were an independent company why couldn't they rent that space to the electric company? [R. p. 4376] A. Well, I would say that that

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VIRGINIA GAS (Cont'd)

would be a managerial decision, and if I had anything to do with it I don't believe you would keep it there.

Q. That is because you wouldn't want your competitor in the same building. A. That is because if two interests get together, why, I don't believe they get along very well. We have a common interest now and it would be separate interests under this proposed gas company being a separate company. There wouldn't be anything in common.

Q. Would you say that if the gas department were independent that they would have conflicting interests with the electric operations? A. I think the gas, another gas company would try to do its best job, and they may want to do things differently than they are being done now.

Q. You wouldn't say that the interests of a gas utility and an electric utility though would run cross current, would you? A. I believe they would if they were separate.

* * * * *

VIRGINIA AND EL PASO TRANSPORTATION

T. NORMAN JONES

Direct Examination

[R. p. 510] Q. Will you now contrast the difference in the effect which was produced in your thinking on this subject, and in the [R. p. 511] light of your knowledge of the company's operations, by pointing out the difference in the result if the allocations were made on the former basis, that is the gross operating revenue basis, as compared with the net operating revenue basis? A. Applying to the year 1933 the method of allocating general expense which was applied during the year 1932, on the gross operating revenue basis, the percentage allocated to the Street Railway Department would have been 17 per cent; the percentage allocated to the Bus Department would have been 10 per cent; the percentage allocated to the Electric Department would have

been 66 per cent and the percentage allocated to the Gas Department would have been 7 per cent.

Applying the net operating revenue basis for the year 1933, the percentages were as follows:

11 per cent allocated to Street Railway; 6 per cent allocated to Bus; 77 per cent allocated to the Electric Department; and 6 per cent allocated to the Gas Department; the total percentage applicable to the Transportation Department, Railway and Bus combined, on the gross operating revenue basis being 27 per cent as compared with 17 per cent on the net operating revenue basis.

* * * * *

T. NORMAN JONES

Cross Examination

[R. p. 565] Q. Is there any reason why, if the street railway were owned by a separate company, that the poles could not be used by both the electric department in connection with the street railway operations under the same sort of arrangement that the company has with the telephone and telegraph companies? A. I think undoubtedly a joint use arrangement could be worked out.

* * * * *

[R. p. 568] Q. Well, any company that would have been operating a railway system in Petersburg and wanted to change to bus would have been required to continue to operate busses? A. I think that is true.

Q. So that requirement was not peculiar to the company being engaged in the electric business? A. Well, there is no relationship between the serving of a customer with electricity for light and power and hauling a passenger on a car from that standpoint . . .

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T. Norman Jones—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

[R. p. 600] Q. Would you say that in your opinion the operating problems of the transportation department are so separate and distinct from those of the company's operations otherwise that the transportation department can most economically and efficiently operate under a separate head? A. I think that the problems are so different that it is better to have a man devote his time to the study of transportation problems, and let someone else devote their time to the study of the electric problems, within the limits of the actual operations.

* * * * *

[R. p. 603] Q. Do you know how much property was found to be in the electric utility plant account and used solely by the railway? [R. p. 604] A. I can't answer that, I don't know.

Q. You mean that the State Commission found that there was a substantial amount of property that the company carried in its electric utility property account and it permitted it to remain in its electric utility property account, although it was used solely for railway? A. That it found that there was an amount, whatever the figure was—I don't remember, in the electric plant account that was used in connection with the railway operations.

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J. G. HOLTZCLAW

Direct Examination

[R. p. 760] . . . in the year 1940, 879,045,631 kwh were generated in all of the company's power stations, or purchased from outside sources. Of this amount, 34,162,978 kwh were delivered to the transportation department for the operation of street cars and for miscellaneous uses.

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VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

J. G. HOLTZCLAW

Cross Examination

[R. p. 1158] Q. Has there been enough, in your opinion, accrued each year for the past ten years to the retirement reserve from the Railway Department to take care of the retirements, write-downs and depreciation of railway property? A. We have never separated our retirement reserve among the departments.

Q. However, assuming that an aggregate amount will have been accrued to retirement reserve to cover the electric and gas property depreciation, is it your opinion that the remainder applicable to the transportation department would have been sufficient as an accrual to retirement reserve to cover the amount of the retirements, write-downs, or would it have been sufficient as an accrual in your opinion? A. The property has been written down to approximately $10,000,000. On the basis of depreciation as being accrued at the present time, it can be retired in 15 years, and the property is in such condition as to last considerably longer than that.

Q. However, looking to the past ten years, as to which you were making adjustments, to which you testified in your direct testimony, is it your opinion that if you made a segregation of the accrual to the retirement reserve, so as to show a sufficient accrual to cover the electric and the gas property, is it your opinion that the remainder would constitute a sufficient accrual for depreciation of the railway property and the bus property?

[R. p. 1159] The Witness: Will you read the question.

(Whereupon the pending question, as above recorded, was read by the reporter.)

The Witness: In my opinion, the charge-offs to the Railway Department in the past ten years to the depreciation account represent all the accrued depreciation in it and

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J. G. Holtzclaw—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

it permitted it to run along for 15 years as depreciation as earned after taxes were charged off.

Q. It is your opinion, is it not, that if there were such a segregation as I suggested, the amount that would be shown as the railway accrual to retirement reserve, would not, in your opinion, constitute a sufficient accrual to the retirement reserve in the light of the retirements and write-downs and depreciation of railway and bus properties? A. The answer to that involves an expression of opinion as to what is an ample retirement reserve or depreciation reserve for electric and gas, and that never has been decided. We haven't allocated even the retirement reserve which the company had as of January 1, 1937, between the departments.

Q. If there had been a segregation in the accruals to retirement reserve, is it your opinion that there would be any income after depreciation for the Railway Department over the past ten years?

The Witness: Read that please.

[R. p. 1160] (Whereupon the pending question, as above recorded was read by the reporter.)

The Witness: I don't believe I understand that question, Mr. Fischgrund.

Q. You testified, that making the adjustments that Mr. Taylor proposed for 1940, over the past ten years, there would be $5,227,634 available for depreciation? A. Yes.

Q. And you also testified that the amount of the retirements and write-downs during that period amounted to some $11,000,000? A. That is right.

Q. You also testified that the amount of the retirements alone were some $600,000 in excess of the $5,000,000 figure which you stated was available for depreciation? A. Yes.

Q. In light of that, would you say that, if there had been a segregation of the amount of the accrual to the retirement reserve, a segregation, and that there would be a separate amount allocated to the Railway Department, would it be your opinion that there would still, after such segregation, be any net income after depreciation for the Railway Department? A. Not in the last ten years, no, sir. Very little if any.

[R. p. 1161] Mr. Moore: You mean including the write-offs, is that what you mean?

The Witness: You are including the write-offs in that? By Mr. Fischgrund:

Q. Wouldn't that also be true even if you didn't include the write-offs? A. No, sir.

Q. It would not? A. I don't think so. I haven't got that figure, but I don't think that is true. Including $5,800,000 of write-offs it is true.

Q. How does the inclusion of the write-offs change the amount that you would set up as depreciation charges for the Railway Department, if you segregate the depreciation of the Company during the past ten years? A. Well, you are asking a question referring to the last ten years, as I understood it?

Q. Yes. A. And if we had allocated to the various departments over the last ten years on the basis of some percentage ratio, it would not have been sufficient to have charged off all the property that has been charged up, plus the write-downs in the last ten years.

Q. I believe the question, Mr. Holtzclaw, was addressed to whether or not there would be any net income after depreciation [R. p. 1162] if you had segregated the depreciation of the company by departments during the past ten years? A. I am not prepared to answer that question without further work on it.

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J. G. Holtzclaw—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

Q. Further what? A. Without further work on the subject.

Q. Thank you. Do you know how much of $5,227,634, that you testified would be the adjusted earnings of the Railway Department over the past ten years before depreciation, was paid out in dividends? A. I do not.

Q. Do you know of any amount that was paid out in dividends? A. Not out of Railway earnings. Dividends were paid out of the general funds of the Company.

Q. You don't know whether or not any of it was or was not paid out in dividends? A. Any net left in the Railway operation went into the general funds of the Company and dividends were paid out of the general funds.

Q. In arriving at the adjusted net operating revenues of the Railway Department over the past ten years, you adjusted the expenses of the Railway Department, I believe, by increasing such expenses in the amount of $966,715? A. That is right, sir.

[R. p. 1163] Q. And those expenses were borne by the Electric and the Gas Departments, were they not, over the past ten years? A. Presumably so, yes.

Q. Why do you say, "presumably," Mr. Holtzclaw? Is there a doubt that if they were not charged to the Transportation Department, they must have been expenses of the Electric and Gas Department? A. Joint use of buildings does not represent an expense borne by the Electric Department, as an out-of-pocket expense. The way Mr. Taylor has figured, he has charged the Railway as a rental on the joint use of these facilities, but it has not been an out-of-pocket expense for the Electric Department, except in so far as carrying charges on the building were concerned. That is the reason I say "presumably."

Q. In so far as Mr. Taylor has made the allocation of such expenses, however they were borne by the Electric and Gas Departments? A. That is right.

Q. They were considered as an expense of the Electric and Gas Departments in fixing of electric and gas rates over the past ten years, were they not?

The Witness: Read that, will you please.

(Whereupon the pending question, as above recorded, was read by the reporter.)

The Witness: In so far as they were out of pocket expenses, [R. p. 1164] yes.

Q. But in so far as they were allocated to the Electric and Gas Departments on the books of the Company, rather than the Transportation Department— A. (Interposing) As an operating expense. There have never been rent of buildings or rent of poles or other facilities, rent of manholes, charged on the books.

The Electric Department has carried the charges in the nature of depreciation and taxes, but in so far as they represented out-of-pocket expenses, they have been set up on the expenses of the other two departments undoubtedly.

Q. Then, in so far as they have not been allocated to the Transportation Department, they have been charged as expenses to the Electric and Gas Departments? A. That is right, with the exception of some of the allocations which do not represent out-of-pocket expenses of the Electric Department, which Mr. Taylor has allocated to the Railway.

I refer to the rent of buildings—of space in buildings —the joint use of poles; the joint use of manholes, which, now set up in Railway operating expenses and credited back to Electric operating expenses, have never appeared anywhere in expenses.

According to Mr. Taylor's allocation, now they go to the [R. p. 1165] Railway Department and will be a credit to Electric.

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J. G. Holtzclaw—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

Q. Weren't those expenses shown as an expense of one or another of the departments during the past ten years? A. No, sir, they have not.

Q. They were shown only as Company expenses? A. Not shown as any expenses. There has been nothing set up on their books for the joint use of poles or the joint use of office buildings, or the joint use of manholes.

The Company made the investment in poles and office buildings and manholes, and naturally carrying charges on those various items, but nothing has been set up in operating expenses except in so far as the maintenance and operation expenses of those facilities are concerned.

Q. Do you know what property accounts those items you refer to were carried—that is, poles and manholes? A. I think Mr. Taylor went quite thoroughly into that and his testimony is far better than mine. By and large it is an Electric plant account—those items, office buildings, manholes, some poles in the Electric and some poles in the Railway plant account as testified by Mr. Taylor.

Q. They were considered without recognition of the Railway Department's use of such facilities in fixing electric and gas rates, were they not? A. I didn't understand. Will you read that please.

(Whereupon the pending question, as above recorded, was [R. p. 1166] read by the reporter.)

The Witness: Would you mind asking that again, Mr. Fischgrund. I didn't understand it. "Without recognition."

Q. Well, if the property was carried in the Electric property account and no charge was made or allocation made to any other department other than the Electric Department for the use of such facilities, then in considering the electric rates, any regulatory body necessarily looked at all that property as solely electric property and in looking at the statement and the income statement of the Electric

Department, looked at all of the expense in connection with such facilities as expense incident to the Electric Department, is that not true? A. All of those items have been in the electric rate base and there has been no charge made against Transportation Department for their use. To that extent the Electric Department has benefited.

Mr. Lester: Have the consumers benefited?

The Witness: What?

Mr. Lester: Have the consumers been benefited?

The Witness: Electric or Railway?

Mr. Lester: Electric.

The Witness: No they haven't been benefited, nor have they been seriously injured.

Mr. Lester: They have been injured, haven't they?

[R. p. 1167] The Witness: If the allocation suggested by Mr. Taylor is adopted as the way accounts must be kept in the future, I think the Electric net will be larger in proportion to its rate base and the Railway net will be smaller in proportion to its rate base.

To that extent the Electric rate payers may benefit in the future and the Railway rate payers may suffer in the future.

Q. Haven't the Electric rate payers been injured in the past? A. That depends upon whether or not the Company has earned a fair return on its investment.

* * * * *

[R. p. 1242] Q. As a matter of fact, aside from Mr. Jones, the executives at present devote practically none of their time to the Transportation Department? A. A small percentage of their time.

* * * * *

[R. p. 1244] . . . if the Transportation Department were disposed of, the rapid expansion and growth of the Electric

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J. G. Holtzclaw—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

Department will assure a full day's work for all executives in the company.

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[R. p. 1248] Q. The reason that you testified that there would be an increase in the electric expenses if the Transportation Department were disposed of is that the executives at present are overworked and they have to work on Sundays and longer than normal hours? A. No. The 16 executives work very hard and sometimes long hours. My judgment is that if the Transportation Department were disposed of not one of them can be dispensed with.

Q. And it is your opinion that they would have to work just as hard? A. I think so. The growth in electric will take up all the slack.

• • • • •

[R. p. 1263] Q. Do you have sufficient demand for space by the electric and gas departments so that you could use it if the transportation department were sold? A. Every office is full, and many of them overflowing.

• • • • •

[R. p. 1265] Q. If you didn't rent the space occupied in the building in Richmond to the transportation department, upon its being sold, do you believe that the electric and gas departments would find reason that would require them to use that space in their normal growth and expansion? A. There is no doubt about it, we could use it right now.

• • • • •

[R. p. 1282] Q. The question is not whether it is right or wrong, I am making the assumption and asking whether or not in your opinion it is not true that if the railway department were sold, and the railway operations continued, that the electric department would receive, for rental from its poles, an amount [R. p. 1283] that would be equal at least to the $3,927.50 allocated to the transportation department?

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

A. Based on your assumption—which I think is incorrect—there would be some change in that figure there, but probably not the same figure.

Q. The same thing would be true as to the rental of manholes and conduits, would it not? A. Based upon the same assumption.

• • • • •

J. G. HOLTZCLAW

Redirect Examination

[R. p. 2183] I have been informed by officials of the Gulf States Utilities Company that the situation at Beaumont, Texas, at the time of the sale of the transportation properties of Eastern Texas Electric Company, was as follows:

During the year 1937 in which the transportation properties were sold, the average number of employees in the Beaumont area was 302, of which only 89 joint-use employees working for both the electric and transportation departments were given transportation passes. The average number of rides per month by these 89 employees having passes was 3,275. The average monthly riding per employee was 37 rides at 6 cents per ride, or a total value of $2.22 per month per employee having passes.

It appears that neither in Beaumont or Baton Rouge was any direct increase in compensation made to employees having such free transportation by reason of the withdrawal of such passes. . . .

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H. C. LEONARD

Cross Examination

[R. p. 1586] Q. Mr. Leonard, does Baton Rouge Bus Company supply any free bus service to employees of Gulf

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H. C. Leonard—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

States Utilities Company? A. No, it does not except in the case of joint employees.

Q. It supplies free bus service to its own employees, [R. p. 1587] that is, employees of Baton Rouge Bus Company, Inc.? A. Yes.

Q. Was free bus service supplied to employees of the Baton Rouge Electric Company before 1938? A. Yes, it was.

Q. In 1938, the electric properties of Baton Rouge Electric Company were transferred to Gulf States Utilities Company, and the transportation properties to Baton Rouge Bus Company, Inc.? A. That is correct.

Q. Was any change made in the salaries of employees of the Baton Rouge Electric Company who ceased to obtain the free transportation service after 1938 because of the— A. (Interposing) No general increase.

* * * * *

L. F. YETMAN

Direct Examination

[R. p. 2936) Q. Mr. Yetman, it appears from the statement marked "Engineers Exhibit 176" that the amount of $124,822.23 was set aside by the El Paso Electric Company system during the year 1940 for depreciation of the transportation and bridge department excluding busses. Will you give us the breakdown of this amount? A. Of the amount of $124,822.23 assigned to the transportation department, including Juarez, for accrued depreciation for the year 1940, $85,722.23 is applicable to the street railway property, including bridge property, of El Paso Electric Company (Texas), $15,000 for street railway and bridge property of El Paso and Juarez Traction Company, and $24,100 to the bus property of El Paso Electric Company (Texas). You will understand that there is no actual segre-

gation of the accrual between departments as yet on the books of El Paso Electric Company (Texas).

* * * * *

L. F. YETMAN

Cross Examination

[R. p. 3058] Q. The charge for DC energy in the interdepartmental charges, which you testified to, is 1.1 cents per kilowatt hour and is based on the company's large wholesale power rate? A. Yes, I believe that is correct.

Q. The power rate for large wholesale sales includes the profit to the company? A. There is some element of profit there, I would say.

Q. And also the charge for AC energy, as made to the transportation department in the interdepartmental allocation of costs, which you proposed and testified to yesterday, is based on the rate for that class of service, is that not true? A. The regular prescribed rate, yes, sir.

Q. That rate also includes the profit of the electric department? A. I would say there is some element of profit, yes,

* * * * *

[R. p. 3073] Q. Now, are all the poles used jointly by the transportation and the electric departments, carried in the electric utility property account? A. No, I think there are some jointly used poles that are in the railway plant account.

* * * * *

[R. p. 3074] Q. If the company sold its transportation department, is there any reason why there could not be a joint use agreement for the purchaser's using the electric poles of the company and for the electric department's using the railway poles on a similar basis to your agreement with the telephone [R. p. 3075] company? A. I assume that they probably could be worked out.

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L. F. Yetman—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

[R. p. 3094] Q. Do you believe that if the transportation department were disposed of and the company retained practically all of the joint employees that the company would be efficiently operated? A. Yes, they would, in my opinion, have to retain them to continue on an efficient basis.

Q. And you believe that after the transportation department were disposed of and practically all the joint employees were retained that the company would be efficiently operated? A. Yes, I would say so, if that personnel is retained.

Q. And you believe that all the time of these joint employees would not be required in the operation of the electric system, however, do you? A. Yes, I believe they could be advantageously used in the operations of the electric system.

Q. You don't contemplate any expansion of the electric system during the next few years to require the increased time and personnel, do you? A. Oh, yes, yes. As we add new customers that natural expansion would require the use of them, certainly.

Q. In other words, you think the electric system would [R. p. 3095] be efficiently operated with all of the joint employees after the transportation system were disposed of because the expansion of the electric system would take up the time of joint employees, which time they now devote to transportation matters? A. That would be correct, yes.

* * * * *

R. S. NELSON

Cross Examination

[R. p. 3143] Q. The electric system does not in any real sense depend on the railway electric load for the economical and a successful operation of the electric system? A. No, sir.

R. S. Nelson—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

Q. In fact, the electric system does not depend on the railway demand in any real sense whatsoever? A. Well, the railway load is a very small item in the total load of the system.

Q. So that today, with the development of the electric system and the replacement of the railway transportation with autos and buses, the railway load is an insignificant portion of the total electric load? A. Yes, sir.

* * * * *

[R. p. 3177] Q. And as a practical matter, if the electric department assumed the burden of the expense of the pension to the transportation employees, the net income of the transportation department, as shown in the reallocated income statement would be increased by the amount of such pension payments, is that not true? A. Yes, sir; if the electric department assumed the expense.

Q. And you have assumed that the electric department would assume that expense on a sale of the transportation department? A. In my judgment it would be obliged to.

Q. You have also testified, have you not, that the net income and the net operating revenues of the transportation department would have a vital effect on the price that the company could obtain for the transportation property? A. I am sure that would be a very important consideration.

* * * * *

[R. p. 3188] Q. If the company discontinued giving free passes to its employees, the operating revenues of the transportation department would increase, would they not? A. To some extent I believe they would.

Q. Likewise the net operating income would increase? A. Yes, sir.

* * * * *

[R. p. 3211] Q. Do you have one man in the company who is directly in charge of the transportation operations of the company? A. Yes, sir.

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R. S. Nelson—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

Q. He does not devote any time to electric operations? A. No, sir.

Q. Is he the man that the company brought into their employ a short time ago to handle the transportation operation? A. He is the man whom we transferred from the Virginia Electric & Power Company some three years ago, I believe, to be general superintendent of the Mesilla Valley Electric Company. He is an engineer and had some transportation training and experience in the Virginia property before coming to the Mesilla Valley Electric Company.

Mr. Lester: He is the man referred to in Mr. Will's testimony.

The Witness: Referred to as what?

Mr. Lester: Referred to as the new man brought in to have charge of the transportation operations.

Mr. Moore: Mr. Davis.

The Witness: Yes, sir. In Mr. Will's reference, I am sure that Mr. Will meant, in his expression "brought in", that [R. p. 3212] I moved him from Mesilla Valley Electric Company in Las Cruces to El Paso last fall to take charge of the transportation operations.

Mr. Lester: Prior to that time, Mr. Will had been general superintendent not only for the electric operations but also for the transportation operations?

The Witness: For a certain period of time.

Mr. Moore: The man was Mr. Davis, wasn't it?

The Witness: John A. Davis, Jr.

By Mr. Fischgrund:

Q. Mr. Davis more or less runs the whole transportation system at present? A. He runs the whole transportation division under my supervision.

Q. He has nothing to do with the electric system? A. Nothing whatever.

* * * * *

R. S. Nelson—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

[R. p. 3213] Q. From an operating standpoint, there is not any substantial relationship between transporting by busses and the transportation and distribution of electric energy, is there? A. Not in the way that you mean, I am sure, but in my opinion I think there is a substantial advantage in the fact that we operate both, organization-wise.

Q. Do you mean by reason of the bigness of the company in having both operations? A. I mean, by reason of the security of the employee, the security we are able to offer to the employee.

Q. If the company were operating an oil business, it would be able to offer quite a bit of assurance of employment to all employees of a substantial nature because of the security of the electric business, is not that true? A. Do you mean if the company were operating an oil [R. p. 3214] business and the electric and transportation business?

Q. If the company were operating an oil business and an electric business, you would have the same relationship that you spoke of that existed between the bus business and the electric business? A. To some extent, I think you might well have it, yes, sir.

* * * * *

[R. p. 3217] Mr. Lester: Is the matter of public relations the only common factor between the two businesses?

The Witness: Well, I do not know as I would call it a common vital factor.

Mr. Lester: It would have to be considered as a vital factor?

The Witness: I would consider it an important factor and I would consider the advantages to the organization as an extremely important factor.

Mr. Lester: Is there any other important factor?

The Witness: No, except to make some money out of each one of them.

* * * * *

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

C. B. TAYLOR

Cross Examination

[R. p. 3460] Q. Well, if I understood you clearly, you stated that in the case of employees for the electric and gas departments you determined that perhaps less time was required to handle the combination service? A. That is so.

Q. But you did not make any such determination or study in respect to employees who render services for the transportation and electric departments? A. Well, you do not have the same combination of services between electric and transportation as you would between electric [R. p. 3461] and gas. You do not have any combination billing, for instance, between electric and transportation. You would not have any meter readings so far as transportation is concerned. So, you are not faced with the same problems in dealing with the combination of electric and transportation as you are in dealing with electric and gas.

Q. In other words, you thought the type of the operation was so distinct that consideration should not be given to the weighting of salaries of joint employees of the electric and transportation departments; is that a correct understanding? A. That is perfectly true.

* * * * *

EXHIBITS

Commission Exhibit 65

[R. p. 6061] EL PASO ELECTRIC COMPANY

EL PASO, TEXAS

August 8, 1941

AIR MAIL

Mr. Wm. E. Tucker
c-o Carlton Hotel
Washington, D. C.

Dear Mr. Tucker:

In connection with the information regarding the time and circumstances under which this company discontinued the practice of affording reduced rates to employees for electric service, which information is needed to complete my testimony before the Securities and Exchange Commission, given upon cross examination appearing on Pages 3189 and 3190 of transcript, I have been glad to investigate this subject since my return to El Paso and submit this letter of explanation to become Commission's Exhibit No. 65.

I find that for many years prior to October 18, 1929, the residential electric rate of the company was a room type rate which resulted in the average customer paying a charge of 10¢ per kilowatt-hour for the first 30 kilowatt-hours used per month, 6¢ per kilowatt-hour for the next 30 kilowatt-hours used per month, and 4¢ per kilowatt-hour for the excess, whereas, the employee rate for residential electric service was the standard rate with a special discount applied to bring the rate down to a flat charge of 7¢ per kilowatt-hour used per month.

As of October 18, 1929, certain changes and reductions were made in the residential service rates to customers, and a memorandum of instructions dated October 15, 1929 was issued by the management to the Accounting Department, which read as follows:

Commission Exhibit 65 (Cont'd)

EXHIBITS (Cont'd)

"EMPLOYEES' HOME LIGHTING RATE
FOR LIGHT AND POWER

"Effective on all meters read after midnight of October 18, 1929, the rate per kilowatt-hour for residence lighting and incidental household power appliances charged employees of this company will be 6¢ net per KWH instead of 7¢."

We find from our records that from October 18, 1929 to February 10, 1934, the net rate of 6¢ per kilowatt-hour was charged employees except in the case of those whose use of electricity had increased to the point where the standard residential [R. p. 6062] rate of the company resulted in a lower cost to them than an average of 6¢ per kilowatt-hour per month, in which case they were changed over to the standard rate. As of February 10, 1934, the employee rate of 6¢ net per kilowatt-hour was made not available to new employees and the gradual changing over of employees' accounts from the special employee rate to whatever new or reduced standard rate became more advantageous, continued to March 1, 1936, at which time the last change-over was accomplished and the special employee rate abolished.

It will be apparent from the foregoing that the policy of the company through the years from 1929 to 1936 was to continue the special employee rate adopted on October 18, 1929, without any further reductions or revisions, and that the elimination of this special rate was a gradual process which did not result in increasing any employee's charge for electricity to any appreciable extent or in such a way as would have been the case if the privilege of reduced rates had been extended for many years on some percentage basis and then suddenly withdrawn. We find no record of any increased compensation having been paid to any employees as the result of discontinuing the practice of offering a special reduced employee rate for electricity. Obviously, no such compensation would have been considered

Commission Exhibit 65 (Cont'd)

EXHIBITS (Cont'd)

in view of the manner in which this special privilege was discontinued as above explained.

Yours very truly,

(Sgd.) R. S. NELSON

R. S. NELSON,
President.

Engineers Exhibit 229

EXHIBITS (Cont'd)

[R. p. 8073] Engineers Public Service Company, Inc.

Form U-13-1
EXHIBIT F

TABULATION OF CERTAIN SPECIFIC SERVICES RENDERED

Financial Assistance

Follows the financial condition of the companies and arranges for necessary financing and refinancing at most advantageous times possible and on the most favorable bases possible, including negotiations for bank loans and sales of securities.

Giving advice and assistance in the drafting of mortgages or supplemental indentures to insure for the companies equitable provisions, such as reasonable covenants, workable release provisions, and fair redemption and sinking fund requirements, and other papers in connection with issues of securities.

Compiles financial statements, Federal and State commission applications for authority to issue and sell securities, stock exchange listing applications, statistical comparisons, preparation of registration statements and prospectuses, applications for qualification of securities in various states under so-called Blue Sky Laws, and other data in connection with the sale of securities.

Relations with Stockholders and Publicity

Preparation and distribution to stockholders and to others of annual and monthly reports, financial and statistical data.

Answering requests for information from stockholders and others interested.

Plans, arranges and disseminates information through articles, news items, advertisements in newspapers or other periodicals, and circulars.

Engineers Exhibit 229 (Cont'd)

EXHIBITS (Cont'd)

Treasury

Obtains loans and arranges renewals of loans, also placing of equipment notes.

Payment of funds to Trustees to meet semi-annual interest on bonds, debentures and notes together with the sinking fund requirements thereon.

Payment of funds to Dividend Paying Agents for quarterly dividends on preferred and common stocks.

Handling, in the first instance, the receipt and disbursement on the proceeds from sale of securities.

Reacquiring of bonds from public to satisfy sinking funds and deposit of same with Trustees.

Validation of mutilated coupons on bonds and advising New York Stock Exchange, when securities are listed.

Signing temporary and definitive bonds issued by companies.

Following cash requirements of companies in order to arrange for bank loans at proper time and compilation of data in connection therewith for the officers of the companies and for the banks interested.

[R. p. 8074] The maintenance of records for the intelligent and adequate handling of the funds received, disbursed or arranged for through New York depositaries and the carrying on of correspondence arising from or pertaining to the various transactions. The records include notes payable, history of outstanding securities, sinking and escrow operations, weekly balances of cash and monthly estimates of cash requirements.

Representing the companies in handling of unusual transactions with trustees, transfer agents, paying agents, registrars and others. Personal contact is possible, which expedites the settlement of any difficulties and obviates the necessity of sending representatives of the company served, thereby saving much time and expense.

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Engineers Exhibit 229 (Cont'd)

EXHIBITS (Cont'd)

Preparation in conjunction with other departments of applications for issue and sale of securities and listing securities on stock exchanges.

Tax Service

Examination and advice relative to the Federal tax returns of the companies.

Studies of unusual transactions to obtain maximum proper tax benefits therefrom.

Study and advice relative to the depreciable base and annual rates for the determination of the allowable maximum proper deduction for depreciation on Federal income tax returns.

General advice offered as a result of continual study of the Revenue Acts, the Treasury Department Regulations, court and tax board decisions and related matters.

Preparation of and advice relative to protests or petitions filed with Bureau of Internal Revenue.

Correspondence and personal conferences with the Internal Revenue Bureau at Washington, D. C., regarding items questioned by Revenue Agents as a result of their examination of income tax returns previously filed.

Preparation and assistance on claims for refund filed with the Bureau together with correspondence with and personal conferences in Washington, D. C., on these claims.

Conferences with State tax authorities relative to questions raised upon examination of the returns and basis of determining tax.

Maintenance of records necessary to furnish intelligent and adequate advice concerning tax matters including a continual yearly record of maintenance and retirement data, filing of copies of returns and conducting correspondence concerning such matters.

To intelligently supervise this work requires experts who have made a special study of and are familiar with

Engineers Exhibit 229 (Cont'd)

EXHIBITS (Cont'd)

the provisions of the Federal Revenue Act relating to Public Utility taxes as well as with the regulations of the Treasury Department. A continual study of the decisions handed down by the Bureau, the courts and the Board of Tax Appeals is necessary to apply such findings to the problems of the companies. If such services were not provided by the supervisory organization it would be necessary for the companies to employ their own tax consultants and assistants or seek advice from outside sources. This alone would not bring to the companies all the benefits they now enjoy since tax problems of many other public utility companies of the system are also handled. The problems so encountered are varied and many, insuring in effect a broad viewpoint of such matters, which would not be the case with a single company.

[R. p. 8075] The experience of the applicant's tax experts with tax measures in various States has been of material benefit in the filing of proper returns and the treatment of various items to obtain maximum benefits in new tax measures adopted. This service reduces considerably the amount of correspondence, study and consideration of the tax measures by employees of the companies.

Accounting Service

Examination of the cost and nature of additional property certified to Trustees.

Preparation of net earnings certificates and other data required to be filed with Trustees.

Preparation of financial and dividend statements for Directors' meetings.

Examination and checking of stockholders' reports and monthly statements and arranging for distribution.

Examination of data supplied to statistical organizations for use in manuals and other publications.

Keeping the books of account and records and preparing consolidated statements of certain companies.

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Engineers Exhibit 229 (Cont'd)

EXHIBITS (Cont'd)

General accounting advice offered and recommendations made as a result of studies of accounting problems, procedure and policy including; distribution of cost of plant purchased, provision for uncollectible receivable losses and establishment of reserves, audit reports and recommendations, advice to improve or eliminate accounting detail consistent with good accounting practice, reports to regulatory bodies, and study of accounting classifications prescribed by Federal and State authorities and advice to companies to assist them in installing same.

Corporation Department Service

In conjunction with counsel, in cases where legal advice is required, and with other departments, the Corporation Department renders services in connection with the following matters:

Preparation of applications and reports to the Securities and Exchange Commission, Federal Power Commission, and other State and Federal commissions with respect to action under State and Federal laws.

Preparation of applications to stock exchanges and personal contact with Exchange officials.

Assists companies in operation under mortgages, such as obtaining releases of property, release of cash, and discharge of mortgages. Prepares release and other applications required to be furnished Trustees.

Assisting in the drafting of indentures, contracts, deeds and other documents.

Coöperates with transfer agents in connection with problems arising on transfers of securities, lost stock certificates, supply of stock certificates and other matters.

Arranges with transfer agents for sending of notices to stockholders for special and annual meetings, obtaining proxies, and other matters in connection therewith.

Engineers Exhibit 229 (Cont'd)

EXHIBITS (Cont'd)

Prepares matters for action at stockholders' meetings, drafts minutes and keeps records of such meetings. [R. p. 8076] Prepares data for presentation to Directors other than financial data, drafts minutes and keeps records of such meetings.

Gives notice to appropriate parties of all action taken at meetings of the Directors and stockholders.

Advises Directors and officers of requirements under State and Federal laws, such as the reporting of security holdings, making applications and filing reports for authority to continue or obtain permission to serve.

Statistical and Budgetary Department

Assembles, compares and analyzes financial and statistical data of the companies to permit intelligent analysis of performance and problems in order to recommend improvements in operating efficiency, sound policies in development of the business and to provide information for present and prospective security holders.

This department provides information drawn from a wider field than that available to one company alone from which executives with opportunities for broader experience are able to make recommendations for improvement in performance and for sound development. All of these contribute to lower rates and improve service for the customers and to greater security and profit to the investors and employees.

Weekly data on energy output and transportation receipts which are received from the companies are tabulated, plotted and compared with other business indices.

Monthly financial and statistical reports are reviewed and comparative data are tabulated and plotted. Such information indicates the relative growth of various classes of business and the efficiency of operation in the different properties. Successful sales and rate policies and operating

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Engineers Exhibit 229 (Cont'd)

EXHIBITS (Cont'd)

methods in individual properties are disclosed and recommended for use in the others. Comparisons are made from time to time with information from other utility systems.

Special studies are required from time to time of particular problems such as the trends and prospects of particular classes of business to determine whether new activities should be undertaken or old ones expanded, curtailed or abandoned.

Life insurance companies, bankers, investment counsellors, and other large holders and prospective purchasers of securities, located in or adjacent to New York, are continuously analyzing the performance and conditions of the companies, and considerable time is required to answer their inquiries regarding financing, earnings, mortgage provisions, franchises, etc., by telephone, by mail or through personal calls.

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Monday, May 17th A. D., 1943

* * * * *

Before Honorable MORRIS A. SOPER, Circuit Judge, sitting by designation, and Honorable JUSTIN MILLER and FRED M. VINSON, Associate Justices.

* * * * *

No. 8394

ENGINEERS PUBLIC SERVICE COMPANY ET AL., PETITIONERS

vs.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

On motion of Mr. John W. Willis, Mr. Milton V. Freeman of the Bar of the Supreme Court of the United States was allowed to argue for the respondent pro hac vice by special leave of Court.

Argument commenced by Mr. William E. Tucker, attorney for petitioners, continued by Messrs. T. Justin Moore, attorney for petitioners, and Milton V. Freeman, attorney for respondent, and concluded by Mr. T. Justin Moore. Respondent having been permitted to furnish copies of its brief filed in the Supreme Court of the United States in the North American case, petitioners are allowed to furnish copies of the brief for the North American Company in that case.

United States Court of Appeals for the District of Columbia

No. 8394—April Term, 1943

ENGINEERS PUBLIC SERVICE CO. ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

Order

It is ordered by the court that the above-entitled case be, and it is hereby, set down for reargument on Friday, October 1, 1943.

Dated September 27, 1943

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United States Court of Appeals

DISTRICT OF COLUMBIA

No. 8394

ENGINEERS PUBLIC SERVICE COMPANY, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

Petition to Review Orders of Securities and Exchange Commission

Decided November 22, 1943

Messrs. William E. Tucker and T. Justin Moore, with whom *Messrs. Paul D. Miller* and *George D. Gibson* were on the brief, for petitioners.

Mr. Milton V. Freeman, pro hac vice, by special leave of Court, with whom *Mr. John F. Davis*, Solicitor, Securities and Exchange Commission, was on the brief, for respondent.

Before SOPER and ALBERT LEE STEPHENS, Circuit Judges, sitting by designation, and MILLER, Associate Justice.

SOPER, *Circuit Judge:* This petition, filed under § 24 of the Public Utility Holding Company Act of August 26, 1935, 49 Stat. 803, 15 U. S. C. A. § 79 (x), seeks a review of an order issued by the Securities and Exchange Commission on September 16, 1942, in a proceeding begun February 28, 1940, under § 11 (b) (1) of the Act, 15 U. S. C. A. § 79 (k) (b) (1), whereby Engineers Public Service Company was ordered to divest itself of ownership and control of certain subsidiary corporations, and was allowed to retain as its principal system the electric utility system of the Virginia Electric and Power Company, with leave to petition within fifteen days for leave to retain as its principal system the electric utility system of the Gulf States Utilities Company instead of that of Virginia. By additional order of October 6, 1943, Engineers' petition for rehearing and leave to adduce additional evidence was denied except that the fifteen day period was allowed to run from the last mentioned date. The petition for review also covers this order.

Engineers was incorporated in Delaware in 1925 and has its principal offices in New York City. It is a registered holding company under § 5 of the Public Utility Holding Company Act, 15 U. S. C. A. § 79 (e). Prior to the divestment order of September 16, 1942 the Commission had passed a divestment order on July 23, 1941 and Engineers had taken certain steps to comply therewith. Disregarding the properties dealt with in the earlier order, Engi-

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neers, through stock ownership, controlled the following companies on September 16, 1942:

Virginia Electric and Power Company:

This company, referred to herein as "Virginia", carries on an electric utility business in Virginia and North Carolina, and a gas utility, a street railway, a bus and an ice business in Virginia.

Savannah Electric and Power Company:

This company, referred to herein as "Savannah", carries on an electric utility and a street railway and bus business in Georgia.

Gulf States Utilities Company:

This company, referred to herein as "Gulf States", carries on an electric utility and a steam and water business in Texas and Louisiana, a gas utility business in Louisiana and an ice business in Texas.

Baton Rouge Bus Company, Inc.:

This company, referred to herein as "Baton Rouge Bus" carries on a bus business in Baton Rouge, Louisiana.

El Paso Electric Company (Delaware):

This company is also a registered holding company and controls through stock ownership (a) El Paso Electric Company (Texas), referred to herein as "El Paso", which is an electric utility, operating in Texas and New Mexico, and owns a street railway and bus business operating in El Paso, Texas, and the American half of two international toll bridges between El Paso, Texas, and Juarez, Mexico, and (b) El Paso and Juarez Traction Company, which owns a street railway in Juarez, Mexico, and the Mexican half of said international toll bridges.

The subsidiaries of Engineers, in amounts aproximately proportionate to their respective gross earnings, hold stock control of Engineers Public Service Company, Inc., a mutual service company organized and having its executive offices in New York.

Engineers also owns a minority stock interest in El Paso Natural Gas Company.

Virginia, Savannah, Gulf States and El Paso also carry on electric merchandising and jobbing businesses, and Virginia and Gulf States carry on gas merchandising and jobbing businesses.

Thus it appears that Engineers controls gas and electric utility companies which serve widely scattered sections of the country. Electric service is furnished in Virginia, North Carolina, Georgia, Louisiana, Texas and New Mexico. Gas service is rendered in Virginia and Louisiana by the subsidiaries which render electric service in those states. The subsidiary companies in the system

also engage in various other businesses such as bus and street railway systems, interurban and suburban transportation lines, toll bridges, ice and cold storage plants and various water and steam enterprises.

The principal subsidiaries in the order of their importance measured by net income in 1940, are Virginia, Gulf States and El Paso. On December 31, 1940, prior to the divestment order of July 23, 1941, the book value of Engineers' assets was $375,000,000.

Engineers exercises active control over its subsidiaries by virtue of its voting power. It elects the Boards of Directors, designates and transfers executive officers; and through the Service Company, it arranges for the financing of its subsidiaries, negotiates their loans and sales of securities, reviews the contents of their reports to regulatory bodies, and tax authorities, and prepares and distributes reports for the stockholders and general publication.

By its order of September 16, 1942 the Commission required Engineers within one year (1) to dispose of its interest in the following companies: Savannah, Gulf States, Baton Rouge Bus, El Paso Electric Company (Delaware), El Paso Electric Company, Texas, El Paso and Juarez Traction Company, El Paso Natural Gas Company and Engineers Public Service Company, Inc.; and (2) to cease to own or operate any property now owned or operated through Virginia Electric & Power Company for the purpose of conducting any gas utility, gas appliance merchandising and jobbing, and transportation businesses.

The order also required (1) El Paso Electric Company (Delaware) to dispose of its interest in El Paso and Juarez Traction Company; (2) to cease to own or operate any facilities now owned or operated by it through El Paso Electric Company (Texas) for the purpose of conducting any transportation or toll bridge business.

The order gave the Engineers the right within 15 days to petition for leave to retain as its principal system the electric utility system of Gulf States.

It will be perceived that under the order Engineers was ordered to rid itself of all its holdings except Virginia; and Virginia was ordered to rid itself of its gas utility, gas appliance merchandising and jobbing business, and also its transportation business. The holdings that Virginia was permitted to retain consisted of the Virginia Electric and Power Company, its electric appliance merchandising and jobbing business and its ice business.

Engineers contends that the order of the Commission is invalid because (1) it is based upon an erroneous interpretation of the Act; (2) it impeded the Engineers in the selection of the principal system to be retained; (3) the statute is unconstitutional when considered in the light of evidence rejected by the Commission

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which shows that the divestment provisions of the statute are arbitrary and capricious in that they have no substantial relation to the evils which Congress desired to eliminate.

Interpretation of Section 11 (b) (1) of the Statute

The character and content of the order of September 16, 1942 were influenced by the Commission's interpretation of the provisions for the simplification of holding company systems contained in § 11 (b) (1) of the Act.

Section 11 (a) and (b) are as follows:

"*Simplification of Holding-Company Systems*

Sec. 11 (a) It shall be the duty of the Commission to examine the corporate structure of every registered holding company and subsidiary company thereof, the relationships among the companies in the holding-company system of every such company and the character of the interests thereof and the properties owned or controlled thereby to determine the extent to which the corporate structure of such holding-company system and the companies therein may be simplified, unnecessary complexities therein eliminated, voting power fairly and equitably distributed among the holders of securities thereof, and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public-utility system.

(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

(1) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system: Provided, however, That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that

(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;

(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and

(C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

The Commission may permit as reasonably incidental, or economically necessary or appropriate to the operations of one or more integrated public-utility systems the retention of an interest in any business (other than the business of a public-utility company as such) which the Commission shall find necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems."

It is the duty of the Commission under this section to examine the corporate structure of every registered holding company and its subsidiaries, the relationships among them, and the interests and properties thereof, in order to determine to what extent the corporate structure of the system may be simplified and the properties and business confined to those necessary or appropriate to the operation of an integrated public utility system. As applied to the electric utility companies, such a system is defined in § 2 (a) (29) of the Act, 15 U. S. C. A. § 79 (b) (a) (29) to mean a system consisting of generating plants and distributing facilities, whose assets are physically interconnected and may be economically operated as a single system confined in its operations in a single area or region in one or more States, and not so large as to impair the advantages of localized management and efficient operation and regulation. As applied to gas utility companies, such a system means a system consisting of one or more gas utility companies, so located and related that substantial economies may be effectuated in a single coordinated system confined in its operations to a single area or region in one or more States, and not so large as to impair the advantages of localized management and efficient operation and regulation.

The duty is imposed upon the Commission to require each registered holding company and each subsidiary thereof to limit the operations of the system to a single integrated public utility system "and to such other businesses as are reasonably incidental or economically necessary or appropriate to the operations of such integrated public utility system." But the duty and power of the Commission to simplify holding company systems is limited by the proviso that the Commission shall permit a holding company to

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continue to control "one or more additinal integrated public utility systems" if the Commission finds that the additional systems conform to the terms of paragraphs (A), (B) and (C) of the section. Moreover, the Commission is directed, when determining whether other businesses are reasonably incidental or economically necessary or appropriate to the operation of the system, to permit "the retention of an interest in any business (other than the business of a public utility company as such)[1] which the Commission shall find necessary or appropriate to the public interest or for the protection of investors or consumers, and not detrimental to the proper functining of such system or systems."

It is the interpretation which the Commission has placed upon these limitations upon its power that is the subject of dispute, particularly the meaning attributed by the Commission to paragraph (B) relating to the location of additional systems permitted by the Act, and the meaning attributed by the Commission to the final sentence of the section relating to the retention in a system of businesses other than the business of a public utility company. For example, the Commission held that if Engineers chose to retain Virginia as its principal integrated system, it could not also retain Gulf States because the Gulf States properties are not in Virginia or in States adjoining thereto; and that Virginia could not retain the street railway and bus transportation businesses in Virginia and adjoining States because they were not functionally related to its electric utility business.

Additional Integrated Public-Utility Systems

It is clear that the Commission must permit a holding company to continue to control one or more integrated public utility systems in addition to its principal system, if the Commission finds that the additional systems conform to the standards of economy of operation, geographical locality and size, set out in Paragraphs (A), (B) and (C) of the section substantially as follows: (A) Each additional system canot be operated independently without the loss of substantial economies; (B) all of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and (C) the continued combination of such systems under one control is not so large as to impair the advantages of localized management, efficient operation, or effectiveness of regulation.

The Commission considered this matter in connection with its order of July 23, 1941 and stated in its opinion at that time that the dominant question was the proper interpretation of the geographical requirements of paragraph (B). Consequently, consideration

[1] The term "public-utility company" as used in the Act means an electric utility company or a gas utility company, § 2 (a) (5), 15 U. S. C. A. § 79 (b) (a) (5).

was limited to this paragraph without receiving evidence as to the bearing of paragraphs (A) and (C) upon the business and properties of Engineers which do not lie in the same State as the principal system or in States adjoining thereto. The Commission reached the conclusion that paragraph (B) should be interpreted to mean that the additional systems must not only be located in one State, or in adjoining States or in a contiguous foreign country, but also in the *same* State with the principal system, or in a contiguous foreign country. In other words, the Commission gave paragraph (B) the same meaning as if it read: "All of such additional systems are located in the same State as the principal system or in adjoining States or in a contiguous foreign country"; or, as the Commission itself said, paragraph (B) should be construed as if it read: "(B) All of such additional systems are located in a State *in which the single integrated public utility system operates*, or in States adjoining such a State, or in a foreign country contiguous thereto."

It is contended by the holding company that the text of the statute does not support this exegesis because the provision is that all the *additional* systems shall be located in *one* State, and not that all the systems, principal and additional, shall be located in one State or the same States; and it is suggested that the incongruities that would result from the association of systems far removed from one another under the two area interpretation would be obviated by applying standards (A) and (C) which preclude the retention of additional systems unless the Commission itself finds that they are needed to effectuate substantial economies and are not so large as to impair the advantages of localized management, efficient operation or the effectiveness of regulation.

The one area interpretation adopted by the Commission depends upon the legislative history of the Act and the general purposes therein expressed. The Bill originally passed by the Senate required the complete elimination of a holding company unless it could be continued as a first degree holding company, and unless the Federal Power Commission should issue a certificate that continuance was necessary for the operations of a geographical and economically integrated public utility system serving an economic region in a single State or extending into two or more contiguous States, or into a contiguous foreign country. The House modified this provision and substituted a direction that the Securities and Exchange Commission should require each holding company and its subsidiaries to limit their operations to a single integrated public utility system; except that if the Commission should find that it is not necessary in the public interest to so limit the operations of the holding company system, the order of the Commission should require the company to take only such action as the Commission should find necessary to limit the operations to such number of

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integrated public utility systems as might be consistent with the public interest. The basic divergence between the two bills was that the Senate bill limited the retainable systems to those serving a single economic region while the House permitted the retention of as many systems, regardless of location, as the Commission might find to be consistent with the public interest. The present act was worked out as a compromise by conferees who pointed out that it was less rigid than the Senate bill and less flexible than that of the House. The Conference Report (H. R. Rep. No. 1903, 74th Cong., 1st Session, pp. 70–76) contained the following paragraph which, in the Commission's view, sustains its argument:

> The substitute, therefore, makes provision to meet the situation where a holding company can show a real economic need on the part of additional integrated systems for permitting the holding company to keep these additional systems under localized management with a principal integrated system. Under such circumstances the Commission is directed to permit the holding company to retain control of such additional systems, even though not physically integrated with the principal system, provided all such integrated systems are located on the part of additional integrated systems for permitting the contiguous foreign country.

The Commission also relies upon the comments of certain representatives in Congress during the passage of the bill upon the effect of the Conference Report; and more particularly upon an address in the Senate by Senator Wheeler, one of the conferees, immediately after the passage of the Act in its present form and before its approval by the President in which the Senator, commenting upon paragraphs (A), (B), and (C), interpreted paragraph (B) to mean that the additional systems must be in the same region as the principal system. 79 Cong. Rec. 14166–14167, 14168, 14479.

The matter is not free from doubt but in our view the interpretation of the Commission is correct. The quoted passage from the Conference Report speaks in sequence of "additional integrated systems", "these additional systems", "a principal integrated system", "such additional systems", and concludes with the proviso that "all such integrated systems are located in the same State or States or in adjoining States". This final clause is broad enough to include both the previously mentioned "principal integrated system" and also the "additional systems", and it is a weighty circumstance that this meaning was publicly attributed to paragraph (B) in the Senate by one of the conferees before the present controversy had arisen.

Persuasive also are the irrational and incongruous consequences that would flow from the two area interpretation as may be illustrated by its application to the properties in the Engineers' system. It would be possible for the holding company to retain widely separated and totally unrelated properties under one control, as by selecting Virginia Electric & Power Company, located in Virginia and North Carolina, as the principal single integrated system, and associating therewith as additional integrated systems Gulf States and El Paso, located in Louisiana, Texas and New Mexico, notwithstanding the entire absence of operational relationship or normal common interests between them. And, if this choice were made, Virginia could not retain control of the Virginia gas system or of any other system located in Virginia or its adjoining States because these States do not adjoin Louisiana and Texas or New Mexico. It is true that the one area interpretation seems also to lead to certain inequalities since it restricts the permissible area covered by a principal and additional systems more severely when the principal system is located in a State such as Maine, which has few adjoining States than it does a State like Missouri to which eight States are contiguous. But, it must be remembered that in the latter situation all the additional systems submitted for retention, which in theory might be very numerous, would be retainable in actual practice only of it could be shown to the satisfaction of the Commission that they also comply with standards (A) and (B). This condition actually confronted Engineers in the pending case when it was held that it could not retain control of Savannah Electric & Power Company of Georgia as an additional system to Virginia Electric & Power Company, located in the adjoining States of Virginia and North Carolina, because it was not shown that Savannah could not be operated independently without substantial loss of economies as required by paragraph (A).

It is clear from paragraphs (A) and (C) that Congress deemed it desirable and wise to prohibit combinations of systems that produce no economy of operation, or are so large as to impair the advantages of local management, efficient operation and effectiveness of regulation. The same idea is found in more general terms in various portions of § 1 of the Act which declares, among other things, that all provisions of the Act shall be interpreted so as to meet the problems and eliminate certain enumerated evils connected with public utility holding companies, among which are those which result from the growth and extension of holding companies which bear no relation to economy of management and operation or the integration of related operating properties. § 1, (b) (4); § 1 (c). Obviously the Act was designed to eliminate the difficulties and complexities that attend the investor, the con-

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sumer and the State authorities when dealing with subsidiary public utility companies in different States; § 1 (b) (1), (3), (5); and these provisions in themselves, as well as the Congressional debates, show beyond question that among the prime purposes in view was the reduction in size and complexity of holding company system. It follows that the order of September 16, 1942, should be sustained insofar as it requires Engineers, assuming Virginia to be the principal system, to divest itself of such additional systems as Gulf States and El Paso, which are not located in the State of Virginia or States adjoining thereto.

Savannah Electric & Power Company as an Additional System

There are, however, other systems which satisfy the one area interpretation of paragraph (B) as additional systems, if Virginia be considered the principal system, because they are located in the State of Virginia or in adjoining States. Thus, Savannah Electric & Power Company qualifies under paragraph (B) because it is located in Georgia, and Virginia Electric and Power Company is located in Virginia and in North Carolina, that adjoins Georgia. But, Savannah serves only the City of Savannah and its suburbs, which are surrounded by a marshy uninhabited area and its electric system is located 315 miles distant from the electric system of Virginia at the closest point and 550 miles distant at the farthest point, and there is no operational relationship between them. Hence the Commission found that Savannah did not comply with the standard of substantial economy set up by paragraph (A), or the standard of size in respect to the advantages of localized management and efficient operation set up by paragraph (C); and no complaint of these determinations is made by Engineers in the presentation of its petition for review.

Virginia Gas System as an Additional System

Objection is made, however, to the ruling of the Commission that Virginia divest itself of its gas system (held by the Commission to be an integrated public utility system under § 2 (a) (29) (B)), because it is not shown that its severance would result in the loss of substantial economies, as required by paragraph (A) of § 11 (b) (1). The gas system serves an area of 35 square miles in Norfolk and its environs, and has been operated in combination with Virginia Electric properties under joint control since 1900. Engineers acquired the properties in 1925. The combination consists of a gas property of the book value of approximately $6,000,000, with electric properties of the book value of approximately $68,000,000. The gross revenues are approximately $1,000,000 and $15,000,000

respectively. Long operation under single ownership has resulted in certain economies in the joint use of personnel and property. There are 387 employees who work for the gas and other businesses in the combination, and property valued at $2,178,013, including office buildings, equipment, store rooms, automobiles and trucks is jointly used. Interdepartmental activities include the sale of gas and electricity, free transportation of employees and free advertising in street cars and buses.

The economies which would be lost by severance are in two classes: (1) Actual expenses now allocated to the gas property which would have to be paid by the electric properties even after separation; and (2) increased cost of operations of the gas properties as an independent business. The economies in the first class are chiefly caused by the joint use of personnel and property and amount to $55,969 annually; and this figure is not questioned by the Commission. The economies in the second class which would be lost by separation were arrived at by comparing the present costs of operation allocated to the gas properties with the estimated cost of an independent gas system. This estimate was prepared by executives of Virginia and no countervailing evidence was offered. The estimate of increased expenses was $71,522 annually as to which the Commission said that the record would not sustain the finding of more than one-half the amount. This would be equivalent to an increase of 4.6 per cent in the 1940 gas operating expenses and a decrease of 13.3 per cent in the gross gas income, and 29.8 per cent in the gas income available for dividends in that year.

The Commission concluded that this loss of economies was not "substantial" within the meaning of paragraph (A). It said that the Act does not permit a retention of additional systems "unless there is clear and convincing evidence of a loss of economies which would seriously impair the effective operations of the systems involved." It also adverted to the possibility that the increased cost of a separate staff for the gas properties might be offset by increased income resulting from the activities of full time employees completely loyal to the interests of the gas business as distinguished from the competing electric business.

Majority Opinion on Retention of Virginia Gas System as an Additional System

Coming now to the exact situation before us, we must determine whether or not the facts as they were revealed at the hearing give reasonable support to the Commission's conclusion that "substantial economies" would not be saved to "Virginia Gas" by reason of "Virginia Electric's" continued control of the former.

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"Substantial economies", means something different and, we think, something more than substantial savings in operational expenses. Congress could have said that the divorcement shall not be decreed if the controlling utility or the controlled utility show at a hearing that the cost to operate the latter separately from the former would be substantially greater. If the Act can be construed as meaning just that, then the severance ordered here is wrong. "Substantial economies" must mean, as was said in North American Co. v. Securities and Exchange Commission, 133 F. 2d 148, 152, (CCA2), "important economies." The required *importance* must relate to the healthful continuing business and service of the freed utility. But Congress was not so much concerned with the profit motive of utilities as with the evils that had become prevalent through combinations of utilities. It was first concerned with the wiping out of the evils which the practice of utility combinations had produced, and Congress only consented to dull the blade of its chosen weapon in proved hard cases.

It seems clear that the Commission understood its duty when it required a clear and convincing showing that the operational savings through combination would be sufficient to support a finding that such single item of saving would constitute an overall substantial economy. In the circumstances of this case such a finding would have to be based upon the premise that the utility when freed from its controller would go forward upon its own bottom as an independent medium for the serving of a commodity in general demand without change in policy, serving practically in the same way, making practically the same gains, suffering practically the same losses. Here is a broad field, as it seems to us, that was within the area of the required showing by the petitioner. It would be rash to assume that so important an event as the freedom of a corporation from the ownership and control of another corporation engaged in a business to some extent intercompetitive, would not affect the business in anywise.

The evidence produced at the hearing by the petitioners went in its practical entirety to the operational expenses of "Virginia Gas" under "Virginia Electric's" control and as they would be after separation of these two utilities. This, no doubt, was proper evidence but was not conclusive of the issue.

It is our belief that the Commission could not legally "permit" the continued control of "Virginia Gas" by "Virginia Electric" unless it could be found from the evidence adduced at the hearing:

(a) That there would be a continuing substantial strength enjoyed by the controlled company which it would not have under its own control.

(b) That there would be in the situation no reasonable expectation that a compensating strength would not be enjoyed by reason of its own control.

(c) That such continuing strength would not entail a sacrifice upon the part of the controlling utility.

In short, we are of the opinion that the mere showing of a material saving in operational expense (which, to some extent at least, would normally be expected) does not necessarily show the overall situation. This single item may or may not indicate a net economy of any figure. In the circumstances we cannot hold as error the Commission's finding that the divestment of "Virginia Gas" from "Virginia Electric" would cause a substantial loss to "Virginia Gas."

Minority Opinion on Retention of Virginia Gas System as an Additional System

The majority opinion on this subject does not seem to give sufficient effect to the obvious intent of Congress to protect an established association of public utility systems under common control when it is found to satisfy the standards of substantial economy, restricted geographic location and moderate size described in paragraphs A, B and C respectively of § 11 (B) (1). It is the opinion of the writer that the Commission is directed by the statute to give as much weight to these paragraphs as to the provisions of the section immediately preceding, which require the limitation of the holding company system to a single integrated system with certain additions. This conclusion is reasonable because the evils which the statute was designed to eradicate do not prevail under the conditions described in the lettered paragraphs; and it is certain, as the legislative history shows, that the Act would not have received the approval of Congress if it had not contained the provisions which prohibit the unnecessary disturbance of existing conditions.

If the terms of paragraph (A) are given normal meaning and weight, it is hard to understand why substantial savings in operational expenses do not amount to the "substantial economies" upon which the application of the paragraph depends. The findings of fact by the Commission are of course conclusive, if supported by substantial evidence, § 24; but in this instance the evidence is undisputed and it remains only to decide whether a loss of substantial economies would result from a severance of the two systems. It is putting it too strongly to say, as the Commission did, that there must be clear and convincing evidence of loss of economies which would seriously impair the efficiency of the systems. The Act does

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not require more than a preponderance of evidence to support such a finding; nor does it require that the economies must be so great that their loss would seriously impair the system. Such a loss would not be merely substantial; it would be destructive.

A loss of substantial economies occurs if they are so large that experienced men of affairs would regard them as substantial and if possible, take steps to eliminate them. An annual loss of $91,730, that is $55,969 plus one-half of $71,522, even in a business as large as that of Virginia Electric & Power Company, would meet this test and the unnecessary toleration of such a loss by management would subject it to justifiable criticism by investors and by state authorities charged with the duty to protect consumers from unnecessary expense. The intent to protect investors and consumers is shown by the concluding sentence of § 11 (B) (1), and it is evident that Congress had the same idea in mind in its reference to substantial economies in paragraph (A) as it did in the last sentence when it directed the Commission, under certain circumstances, to permit the retention of other businesses as economically necessary or appropriate to the operations of an integrated system if found necessary or appropriate for the protection of investors or consumers.

The conjecture of the Commission that compensating advantages might result from separate management adds no weight to the findings, for the sufficient reason that it is entirely without support in the evidence. No one in the present case questions the efficiency of the present joint operations.

It is worth while to add that the savings from joint operations mentioned above is the minimum figure accepted by the Commission. In addition, there were other estimated losses based upon the judgment of men of experience that relate to consumers' accounting and collection, sales promotion expense and administrative and general expense. The Commission did not deny the existence of additional savings in these categories but said that the estimates were excessive and therefore rejected them without finding the correct figures. The conclusion of the writer is that there was no substantial evidence to warrant the finding that there would be no loss of substantial economies in the separation of the gas from the electric utility system of Virginia, and that the order of the Commission in this respect should not be sustained.

Gulf States Gas System as an Additional System

Similarly, the Commission made the ruling, said by it to be advisory, that the Gulf gas properties could not be retained as an additional system to Gulf States as the principal system of Engineers. Conformity with standards (B) and (C) was conceded but

it was held that the gas system did not conform to standard (A) relating to the loss of substantial economies from independent operations. Gulf States gas system owns facilities for the distribution and sale of natural gas in Baton Rouge and its surroundings. Gulf States acquired the properties by merging with the Baton Rouge Electric Company in 1938 which owned gas, electric and transportation properties that had been operated under a single management since 1900. The evidence indicated that the savings from the joint use of personnel and property amounted annually to $52,450 and that the additional cost of operating as an independent gas company would be $42,024. Of the latter sum the Commission held that $25,000 had been proved, so that the undisputed evidence showed that the separation of the systems would result in an annual loss of at least $77,000. In 1940 the gross receipts from the gas business were approximately $720,000 and the property account on the books was $1,675,000 as compared with approximately $10,840,000 and $57,770,000 respectively for the Gulf States. In the opinion of the writer the admitted facts establish the retainability of the Gulf gas system as an additional system, if Gulf States is chosen as the principal system.

Other Business Clauses of Section 11 (b) (1)

An integrated public utility system such as Engineers not infrequently includes important subsidiary corporations which are not electric utility or gas utility companies and therefore are not, in the statutory sense, public utility companies which under certain circumstances may be retained as additional systems. These other businesses, however, may also be retained if the Commission finds that they conform with the other business clauses of § 11 (b) (1). The Commission has given a restrictive interpretation to these clauses and so applied them to the Engineers system as to give rise to controversial questions which we now consider.

Each holding company is required by § 11 (b) (1) to take such action as the Commission shall find necessary to limit the operations of the system "to a single integrated public utility system and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public utility system." The section then contains the proviso that permits additional integrated public utility systems if they conform to the standards in paragraphs (A), (B), and (C) which we have discussed. After this proviso comes the following paragraph which is descriptive of the other businesses that the holding company may retain:

> The Commission may permit as reasonably incidental, or economically necessary or appropriate to the operations of one

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or more integrated public utility systems the retention of an interest in any business (other than the business of a public utility company as such) which the Commission shall find necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems.

In the earlier case of The United Gas Improvement Co., 9 S. E. C. 52, decided April 15, 1941, the Commission held that these two clauses must be read together, saying (p. 73):

> We must conclude that the two clauses in Section 11 (b) (1) which refer to the retention of other businesses, when taken together, mean that the Commission *must* permit the retention of other businesses, including investment interests in utilities not subsidiaries, which are found to be reasonably incidental or economically necessary or appropriate to the operations of an integrated public utility system retainable under the control of the holding company, and that as to both investments in non-utilities and interests in non-utilities sufficient to create the statutory parent-subsidiary relationship, these standards may be met if the retention of the investments or other interests is found to be necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems." [Italics supplied.]

If the phraseology of the concluding clauses of the section is given its ordinary meaning, it would seem that any business—other than that of a statutory public utility company—is retainable in the principal system if the Commission finds it "necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such systems"; in other words, if the business is not detrimental to the system, retention must be permitted if it serves the interest of the public *or* of the investors *or* of the consumers— any one of the three. But, in the pending case and in the case of The North American Co., 11 S. E. C. —— (affirmed North American Co. v. Securities & Exchange Commission, 2 Cir., 133 F. 2d 148, 152), the Commission has refused to accept these concluding words as a gloss completely explanatory of the prior phrase which directs the retention of "such other businesses as are reasonably incidental or economically necessary or appropriate to the operations of such integrated public utility systems." In its opinion in the pending case, — S. E. C. —, the Commission said:

> • • • But these provisions do not contain isolated standards. They are a closely knit part of a statute which

has a clearly expressed policy, and they appear in a section of that statute which is designed to limit the operations of a holding company system to a single integrated public utility system and to reasonably incidental or economically necessary or appropriate non-utility businesses. In applying the statute, therefore, it must be remembered that the phrases "public interest," "protection of investors or consumers" and "detrimental to the proper function of such system" not only illuminate the meaning of "reasonably incidental or economically necessary or appropriate" but themselves derive content from their context in the section and the statute.

Moreover, Congress did not say that "the Commission shall permit the retention of a business which it finds to be necessary or appropriate to the operations of a retainable utility of investors or consumers and not detrimental to the proper functioning of such system or systems." Rather it instructed us to examine these factors in determining whether a business is retainable as *reasonably incidental or economically necessary or appropriate to the operations of an integrated utility system.*

The questions before us, therefore, are not merely, as respondents suggest: Is the retention of this business appropriate for the protection of investors? or, is the retention of this business appropriate in the public interest? or, Is the retention of this business detrimental to the proper functioning of an integrated utility system? Rather, our fundamental inquiry is: Having in mind the protection of investors, the public interest and the proper functioning of an integrated utility system, is the retention of a particular non-utility business reasonably incidental or economically necessary or appropriate in the operations of a retainable utility system? The questions suggested by respondents are thus relevant in attempting to resolve the ultimate issue but they do not exhaust the scope of our inquiry.

In fine, the Commission reverts to the prior phrase and holds that it must deny retention of any "other business" unless it is incidental or necessary or appropriate to the *operations* of the principal system, i. e., unless there is a functional relationship between the operation of the business and the operation of the principal system. For example, the Commission rules that a street railway and bus transportation business is not retainable as an "other business" by Virginia Electric & Power Company, but an ice business is retainable, because the transportation business is not functionally related to the operation of the public utility

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system but the ice business is so related since it serves to heat a service building of the Electric Company in the winter and cool it in the summer.[1]

It seems clear to us that Congress did not contemplate this result, but intended, on the contrary, to forbid the divestment of other businesses, not detrimental to the functioning of the principal system, if retention will serve the interests of the general public or the interests of investors or consumers, irrespective of the functional relationship between these businesses and the principal system. The purpose to eliminate the evils of holding company systems is expressed in the Act in unmistakable terms, but in the provisions of the compromise measure, worked out in the legislative process, it also clearly appears that Congress realized that it was dealing with existing corporate structures that had been operated under common control for a long time and could not be cut down to a single ideal system in every case without disastrous consequences to public and individual interests. The purpose to protect these interests is made abundantly clear by an examination of the legislative history of the Act.

When the Senate Bill (S. 2796) was reported favorably to the body, it embodied a requirement appended to § 11 (b) (1) that holding companies retain only "such business as is reasonably incidental or economically necessary or appropriate to the operation of such system," that is, substantially the same language as is now contained in the first "other business" clause of the section. During the debate an amendment was offered by Senators Minton and Johnson in order to enable an electric public utility system to retain a water utility company or a business consisting solely of owning and operating farm lands for experimental work in agriculture. When the bill came before the House it was liberalized by the insertion of a clause in general terms which prohibited the Commission from directing the divestment of any business unless the Commission should find that retention was inconsistent with the public interest. The Conference Committee substituted the language now found in the second "other business" sentences at the end of § 11 (b) (1), and this was accepted as satisfactory by the Senate (as well as the House) without comment or objection. Obviously the language was regarded as broad enough to permit the retention of such other businesses as Senators Minton and Johnson had in mind when they offered their amendment.

[1] The concluding "other business" clause in § 11 (b) (1) begins with the words "The Commission may permit, &c.", which seemingly indicate a permissive authority rather than a mandatory duty. The word "may" however, was given the meaning of "must" by the Commission in its decision in the case of United Gas Improvement Company, *supra*; and this interpretation is not seriously challenged by the Commission in its present decision which introduces the theory of functional relationship. If the Act is interpreted as giving the Commission a broad discretion to forbid the retention of other businesses that are not detrimental to the functioning of the system, and are necessary or appropriate to the interest of the public or of investors or of consumers, doubtful questions of constitutionality may arise.

Moreover, the other business clauses of § 11 (b) (1) were given this interpretation by the Commission In the matter of American Waterworks & Electric Co., Inc., 2 S. E. C. 972, 983-5, decided December 30, 1937, wherein a holding company which controlled electric utility companies and gas utility companies was permitted to retain other businesses, such as waterworks, coal, appliance sales, electric railway and bus transportation and bridges. The operations of the company extended over an area 300 miles square in Pennsylvania, West Virginia, Ohio, Maryland and Virginia. The assets, amounted to $385,000,000 and the annual earnings to $52,000,000. There was evidence of economies from the joint use of personnel and facilities and retention of the other businesses was permitted although there was no functional relationship between them and the other companies in the system.

The general purposes of the Act will not be frustrated by this interpretation. The Commission has the power and duty to determine whether the interests of the public or of investors or of consumers will be served by the retention of other businesses, and even if it so finds, it must nevertheless require the severance of the other businesses from the system if it further finds that the combination is detrimental to the proper functioning of the system. If all of these findings are favorable to the continuance of the combination, the practical advantages shown by experience to flow from joint operation may still be enjoyed.

Retention of Virginia Transportation Business under the Other Business Clauses

The application of the Commission's interpretation of the other business clauses of § 11 (b) (1) is shown by the provisions of the order which require Virginia Electric & Power Company, as the principal system to be retained, to divest itself of control of its transportation system, consisting of street railway and bus service in Richmond and Norfolk, bus service in Portsmouth and Petersburg, and interurban bus service between Richmond and Petersburg. These activities constitute practically the whole transportation services in these communities. In 1940 the investment was approximately $13,500,000 and the gross operating revenues were approximately $5,000,000. The Commission's order was based for the most part upon the lack of functional relationship between the transportation and the electric utility business in accordance with the theory developed in the quoted passage from its opinion. Moreover, this theory greatly influenced the Commission's findings of fact in respect to the retainability of other businesses associated with public utility system in this case, as will appear from the following excerpt from its opinion:

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The existence on the one hand of a long historical association, or on the other hand of joint personnel and facilities or net returns is perfectly compatible with a combination whose components are not even remotely incidental, or economically necessary or appropriate, although owned and operated under common control.

Again the Commission said, quoting from its opinion in the case of the North American Co., 12 S. E. C. — :

> By the same token, the "substantially and stability of income" afforded by non-utility interests is not, in and of itself, a factor warranting their retention in a public utility holding company system. Substantial and stable income might be afforded by businesses having no imaginable relationship to the economy of management and operation of integrated public utility systems. If the "other business" clauses of Section 11 (b) (1) are not to be removed from their statutory context, and if we are to give full weight to the express standards and the policy of the Act, we cannot find that any business is "reasonably incidental, or economically necessary or appropriate" to the operations of an integrated public utility system or is "not detrimental to the proper functioning" of such a system merely because it is profitable.
>
> The same considerations apply to economies resulting from joint use of personnel. Unless the nonutility business is such that resulting economies are economies in the operation of an integrated utility system or systems, the mere showing of economies is of little weight in determining whether the nonutility business may be retained.

It was from this point of view that the Commission weighed the evidence with respect to the relation of Virginia's transportation business to its electric utility business and the effect of their severance upon consumers, investors and the general public. The evidence tended to show the following facts: The union of the transportation and electric businesses was a historical outgrowth which began in 1909 with the incorporation of Virginia as a railway company with the incidental statutory power to engage in electrical utility operations. From 1909 to 1922 the transportation business was the predominant factor but gradually the importance of the electric utility operations increased until in 1922 they exceeded the transportation operations. Since 1922 the transportation revenues have remained almost stationary while the electric revenues have grown until in 1940 they had become about 75 per cent of the whole.

The joint operation of the businesses has been conducted with the permission of the State of Virginia and has been efficient and

advantageous to consumers. There has been joint use throughout of personnel and property; 13.8 per cent of the transportation employees also perform services for the electric department and a total of 305 employees ranging from executives to minor employees render service to both systems. Joint use is made of property of the value of $2,750,000 which includes office buildings, storage facilities, automotive equipment, poles, manholes, rights of way, &c. The transportation system derives all of its electric energy (at a cost in 1940 of $218,000) from the electric department which has provided special facilities for that purpose. The transportation department furnished free transportation to electric employees to the extent of $108,000 in 1940.

The trolley service has gradually declined and the bus service has gradually grown until it is now slightly over 50 per cent of the whole. The railway system in 1940 received gross operating revenues of $2,447,000 but a net operating deficit of $43,000. The bus properties received gross operating revenues of $2,580,000 and net operating revenues of $151,000 so that the gross income (after depreciation) from the transportation department was $106,000. The net income in 1940 was $24,800. For years the transportation operations as a whole have produced a regular but small annual net profit. Studies offered by accountants indicated economies from joint operation amounting to $249,000 a year, of which $108,000 was credited to free transportation allowed electric employees. The Commission doubted whether a saving was actually made through the free transportation service.

There was also evidence tending to show that a divorcement of the transportation business would involve a considerable loss to the Virginia system since the realizable figure would necessarily be small and the salvage of capital investment which Virginia is now making on its operations through the allowance of annual depreciation would be lost.

From this outline it appears that substantial evidence was presented from which the Commission might have found that the retention of the transportation business was necessary in the public interest or for the protection of investors or consumers, or if not necessary, at least appropriate for these purposes in the ordinary acceptation of these terms; but in the absence of functional relationship between the transportation business and the electric system, no such finding could be made under the Commission's interpretation of the Act. Moreover, the Commission gave as an additional reason for ordering the divestment of the transportation business that the co-existence of the properties under one ownership had been detrimental to the proper functioning of the electric system and adverse to the interests of consumers and investors because much of the property had been carried in the electric

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plant account and insufficient charges against the transportation business for electrical energy and other facilities furnished by the electric system had been made. There was evidence that the accounting methods of the system had been incorrect in some respects; but during the course of the hearing it was shown that the accounting system was under examination by competent accountants who had made recommendations as to the allocation of joint expenses and interdepartmental services which would correctly reflect these operations. The accounts for the operations in the year 1940 were adjusted to meet these recommendations and the accountants were directed to put the new methods into effect. The Board made no specific findings as to the effect of the change saying merely that "it is not clear that the changes completely eliminate the improprieties."

In view of this situation it seems fitting that the matter of the retention of the transportation business be given further consideration by the Commission. It is not the function of this court to make final determinations of fact; that responsibility lies with the Commission under the statute. Its conclusions on this branch of the case were based mainly upon the theory that the other businesses must bear a functional relationship to the system and to a less degree upon its finding that the retention had been detrimental to the system in the past. The first reason, as we have seen, is based on an erroneous interpretation of the Act, while the second relates to past accounting practices with no clear finding as to present conditions. The association of the businesses in combination in the Virginia Electric Power Company, serving the same locality under the supervision of the State authorities, does not appear to have involved the major evils which the Act was designed to eradicate. Historically the combination came about in the normal development of the business of furnishing electric power. The faulty accounting practices which have occurred are not necessarily inherent in the situation and have either been corrected or are in process of correction, according to the undisputed evidence. For these reasons we conclude that so much of the Board's order as relates to the divestment of the transportation business from the Virginia Electric Power Company should be reversed and the case remanded to the Commission for further findings and conclusions.

A similar ruling would be required, if the court should pass on the findings of the Commission in regard to the other businesses which Gulf States and El Paso, respectively, desire to retain.

Selection of a Principal System

In the foregoing discussion, it has been assumed for the most part that Virginia will become the principal system of Engineers.

This may well be the case but so far Engineers has made no selection and now contends that no suitable opportunity to make one has been given it. In 1941, after hearings, the Commission directed Engineers to divest itself of certain subsidiaries not connected with the present review and steps have been taken to that end. The Commission also held that Virginia and Gulf States, the most important subsidiaries of the system, severally constituted integrated public utility systems and that Engineers could not retain both under the one area interpretation but one of them must be selected as the principal system in order that the provisions of § 11 (b) (1) might be applied. The Commission said that the choice between Virginia and Gulf States was a close one which it would assume that Engineers had the right to make provided it was made as promptly as possible.

The Commission recognized the difficulty of an intelligent choice until it had determined what additional systems and what additional businesses could be retained in combination with each of the two subsidiaries. The right of Engineers to require such preliminary determinations to be made was denied but nevertheless the Commission proceeded, in its discretion, to make advisory findings of the character indicated. Thereby Engineers was advised as to what properties it might retain in the event that either system should be chosen as the principal system. Engineers announced that it was not yet ready to make the selection and thereupon the Commission by its order of September 16, 1942 selected Virginia as the principal system, but granted permission to Engineers to ask, within fifteen days, for leave to substitute Gulf States as the principal system. Engineers then filed a petition for rehearing complaining, amongst other things, that fifteen days was insufficient for the purpose; and the Commission, on October 6, 1942, granted an additional fifteen day period to run from that date. Engineers still failed to make a choice and the selection of Virginia by the Commission as the principal system thereupon became final. Since the case must be remanded to the Commission for further findings in accordance with this opinion, the action which the Commission has heretofore taken in respect to the selection of the principal system becomes immaterial; but as the selection of a principal system is essential to any simplification of the corporate structure of Engineers, the legal question involved must be decided.

The statute is silent on the point. It provides only that it shall be the duty of the Commission to pass its simplification order as soon as practicable after January 1, 1938, § 11 (b) (1); and that such an order shall be complied with within one year from its date; but the Commission, upon a proper showing of due diligence by the holding company, may extend the time for an additional

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year if it finds such extension necessary or appropriate in the public interest or for the protection of investors or consumers, § 11 (c). No standards governing the choice of a principal system are set up in the Act.

It is a reasonable interpretation that the holding company rather than the Commission has the right of choice, since the holding company is the lawful owner of the combined properties and the public interests are protected by the grant of power to the Commission to determine what integrated public-utility systems are involved in a given case and what additional systems and additional businesses may be retained therewith under the terms of the statute. The statutory purposes are not impeded by this interpretation and the contention is avoided that the delegation of arbitrary power to the Commission to select the principal system without Congressional standards to guide it would be unconstitutional. While the point was not specifically decided, it was assumed by the Commission in the pending case and by the court in North American Co. v. Securities & Exchange Comm., 2 Cir., 133 F. 2d 148, 151, that in the first instance the privilege of selection belongs to the holding company.

It does not follow that the holding company may delay the selection unreasonably and thereby interfere with or prolong the administrative process. On the contrary, the duty imposed upon the Commission to simplify the corporate structure of the holding company system implies the power to require the holding company to make the selection seasonably, and in case of unnecessary delay, to make the selection itself. However, if selection cannot be made intelligently by the holding company until the permissible composition of alternate systems has been determined, the Commission should make advisory findings as it has done in the pending case. These findings must now be reconsidered in the light of the interpretation of the several provisions of § 11 (b) (1) herein set out; and this procedure need not unduly delay the final disposition of the case since the pertinent evidence has already been taken.

Engineers contend that the right of selection may be exercised by it at any time within the year allowed by the Act for compliance with the Commission's order, that is, the selection must be made and the order put into effect within the year unless the Commission allows additional time for good cause shown. A contrary ruling was made in North American Co. v. Securities & Exchange Commission, supra, on the ground that such deferment of selection would cause unnecessary delay, presumably because it would necessitate alternate findings by the Commission. This reason would obviously not apply when, as in the pending case, alternate findings are essential to a choice. In such event selection of one of

the alternatives and compliance with the order of the Commission in regard thereto within the year would occasion no unnecessary delay.

For present purposes, it is sufficient to decide that the right of selection lies with the holding company; that the right must be exercised without unnecessary delay; that the Commission should make preliminary rulings if they are necessary to enable the holding company to make its selection; that if the holding company does not make its selection in a reasonable time the Commission may designate the principal system; and that the action of the Commission in passing upon the need of preliminary findings and in fixing the time within which the selection of the principal system must be made should not be disturbed by the courts unless it appears that the holding company has been denied a reasonable opportunity to make its choice.

The Excluded Evidence Relating to the Constitutionality of Section 11 (b) (1)

The constitutionality of the Public Utility Holding Company Act was sustained in North American Co., v. Securities & Exchange Commission, supra, and a writ of certiorari was granted by the Supreme Court on March 1, 1943, 63 S. Ct. 764. See also, the Commonwealth & Southern Corp. v. Securities & Exchange Commission, 3 Cir., 134 F. 2d 747. We concurred in the views expressed in this case in Central & Southwestern Utilities Company v. Securities and Exchange Commission, decided June 7, 1943. In the pending case Engineers offered and the Commission excluded evidence of an economic and statistical character purporting to show that the standards set out in § 11 (b) (1), relating to the control of subsidiaries by holding companies and to the size of holding company systems, bear no relation to the abuses that Congress listed in § 1 of the statute and intended to eliminate. It is contended that the proffered evidence conclusively shows the absence of such a relationship and hence the divestment provisions of § 11 (b) (1) are wholly aribtrary and capricious and beyond the Congressional power. The pending case is thus distinguished from the last cited cases in which no evidence bearing on the reasonableness of the section was introduced.

The Commission excluded the evidence on the ground that an administrative body has no authority to weigh evidence of the character described or to pass upon the constitutionality of the Act which it is called upon to administer. It had previously ruled that it has no power to decide constitutional questions in Houston

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Natural Gas Corp., 3 S. E. C. 664, 671; Walston & Co., 5 S. E. C. 112, 113; J. A. Sisto & Co., 7 S. E. C. 647, 653, note 5.

This court decided in Panitz v. District of Columbia, 112 F. 2d 39, that a tax assessor, as an administrative official, has no inherent power to rule on constitutional objections to the tax. We said: (pp. 41-2)

> • • • It has been said that the necessities of our system require the judiciary to determine the constitutionality of Acts of the legislature. There can be little doubt that it represents the highest exercise of judicial power, and one that even the judiciary is reluctant to exercise. Interruption of the machinery of government necessarily attendant on this function not only cautions the judiciary but argues as well against its exercise by other agencies. It is this consideration for the orderly, efficient functioning of the processes of government which makes it impossible to recognize in administrative officers any inherent power to nullify legislative enactments because of personal belief that they contravene the constitution. Thus it is held that ministerial officers cannot question the constitutionality of the statue under which they operate. Likewise, it has been held that an administrative agency invested with discretion has no jurisdiction to entertain constitutional questions where no provision has been made therefor. In respect to taxation it is frequently stated that one need not pursue his administrative remedy where the tax is void. Here again is apparent a reluctance to invest nonjudicial agencies with jurisdiction to rule on the validity of statutes.
>
> From the above we think it clear that the assessor had no inherent authority to consider constitutional objection to the tax.

See, also, Fosgate Co. v. Kirkland, S. D. Fla., 19 F. Supp. 152.

No statutory power is conferred by the Public-Utility Holding Company Act upon the Commission to consider questions of constitutionality or to receive evidence or make findings of fact in respect thereto. Section 24 of the statute provides that "the findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive" but these findings are obviously those which the Commission must make in the administration of the Act and they do not relate to evidence offered to show that the Act is entirely invalid because it lacks the factual basis for the constitutional exercise of the Congressional power.

It is true that an administrative agency must sometimes pass upon constitutional questions of fact in deciding whether it has jurisdiction to apply a statute to a particular individual under a particular state of facts, as in Labor Board v. Clothing Co., 301 U. S. 58, Washington Coach Co. v. Labor Board, 301 U. S. 142, where the contention was made that since the employer was engaged in intrastate commerce, the Labor Act did not apply. In these cases the Board made findings of fact which indicated that the employer was engaged in interstate commerce and this conclusion was sustained by the court since it was based upon substantial evidence. Moreover, a federal District Court has no jurisdiction to enjoin the Labor Board from holding a hearing and deciding whether the jurisdictional facts exist when the charge is that an employer has been engaged in interstate commerce and has been guilty of unfair labor practices under the Labor Act. The power to prevent any person from engaging in unfair labor practices affecting commerce has been vested by statute in the Board subject to review by the Circuit Court of Appeals, and since the employer has thus been given adequate protection against illegal action on the part of the Board, no injunctive action by the District Court is necessary or proper. Myers v. Bethlehem Corp., 303 U. S. 41.

These decisions, however, were required to protect the power of the administrative agency and to prevent interference with the performance of its functions in the application of the statute to the facts of particular cases. There has been no decision which holds that an administrative agency must receive evidence offered to show that its governing statute is invalid, or which empowers the reviewing court to direct the agency to take such testimony or make findings of fact upon it. For the foregoing reasons we are of the opinion that the action of the Commission in excluding the offered testimony must be affirmed.

It does not follow that the petitioner is deprived of the well established right to test the constitutionality of the statute by showing that it is completely lacking in factual basis. We hold merely that the proffered evidence was not admissible at the hearing before the Commission, without prejudice to the right of the petitioner to raise the same question hereafter in such other manner as it may be advised. See the discussion on Introduction before Agencies of Evidence Bearing on Constitutional Issues, Pike & Fischer, Current Text, § 45-a, 22; The Presentation of Facts Underlying the Constitutionality of Statutes, 49 Harvard Law Review, 631; Davis, Evidence in the Administrative Process, 45 Harvard Law Review, 364, 402–10.

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It is apparent from the foregoing discussion that certain portions of the orders under review are in accord with the statute, while other portions should be modified or set aside; but, as the final order should be complete in itself and cover all phases of the case, the Commission's orders of September 16, 1942 and October 6, 1942 will be set aside, and the case remanded to the Commission for further proceedings in accordance with this opinion.

Reversed and Remanded.

United States Court of Appeals for the District of Columbia

No. 8394—October Term, 1943

ENGINEERS PUBLIC SERVICE COMPANY ET AL., PETITIONERS

vs.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

Petition for Review of Orders of the Securities and Exchange Commission

Order and decree

This cause came on to be heard on the transcript of the record from the Securities and Exchange Commission and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the orders of the said Securities and Exchange on review in this cause be, and the same are hereby, set aside and that this cause be, and it is hereby, remanded to the said Securities and Exchange Commission for further proceedings in accordance with the opinion of this Court.

Per Mr. JUSTICE MILLER.

Dated November 22, 1943.

In the United States Court of Appeals for the District of Columbia

No. 8394

ENGINEER'S PUBLIC SERVICE COMPANY ET AL.

v.

SECURITIES AND EXCHANGE COMMISSION

Designation of record

The Clerk will please prepare a transcript on application to the Supreme Court of the United States for certiorari in the above-entitled case, including therein the following:

1. Appendices to briefs of appellants and appellee.
2. Opinion.
3. Judgment.
4. This designation.
5. Clerk's certificate.

CHARLES FAHY,
Solicitor General,
Attorney for Appellee.

[Filed Dec. 18, 1943. Joseph W. Stewart, Clerk.]

United States Court of Appeals for the District of Columbia

I, Joseph W. Stewart, Clerk of the United States Court of

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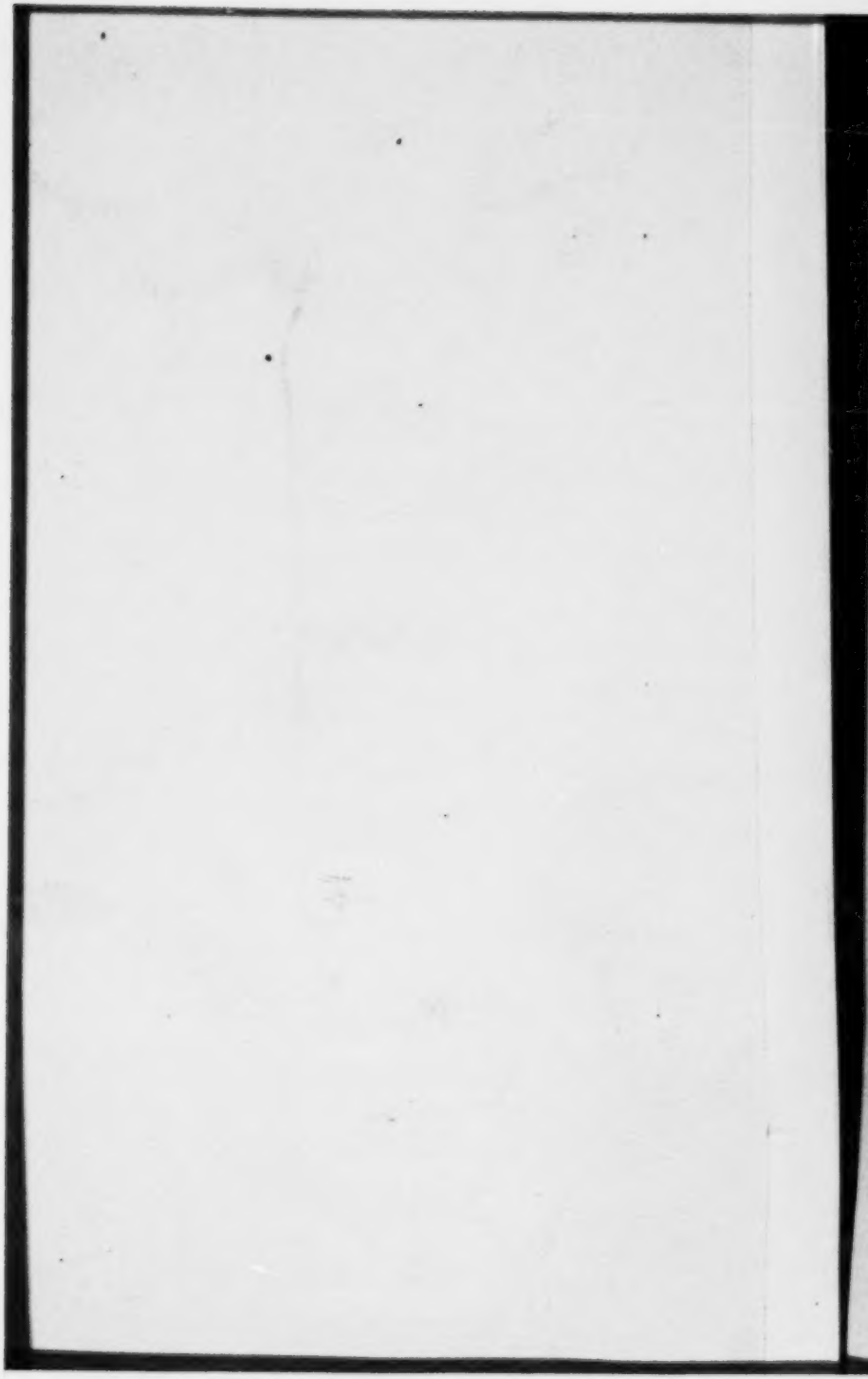
FOR REMAINDER OF PAGE



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from the Securities and Exchange Commission and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the orders of the said Securities and Exchange on review in this cause be, and the same are hereby, set aside and that this cause be, and it is hereby, remanded to the said Securities and Exchange Commission for further proceedings in accordance with the opinion of this Court.

Per Mr. JUSTICE MILLER.

Dated November 22, 1943.

In the United States Court of Appeals for the District of Columbia

No. 8394

ENGINEER'S PUBLIC SERVICE COMPANY ET AL.

v.

SECURITIES AND EXCHANGE COMMISSION

Designation of record

The Clerk will please prepare a transcript on application to the Supreme Court of the United States for certiorari in the above-entitled case, including therein the following:

1. Appendices to briefs of appellants and appellee.
2. Opinion.
3. Judgment.
4. This designation.
5. Clerk's certificate.

CHARLES FAHY,
Solicitor General,
Attorney for Appellee.

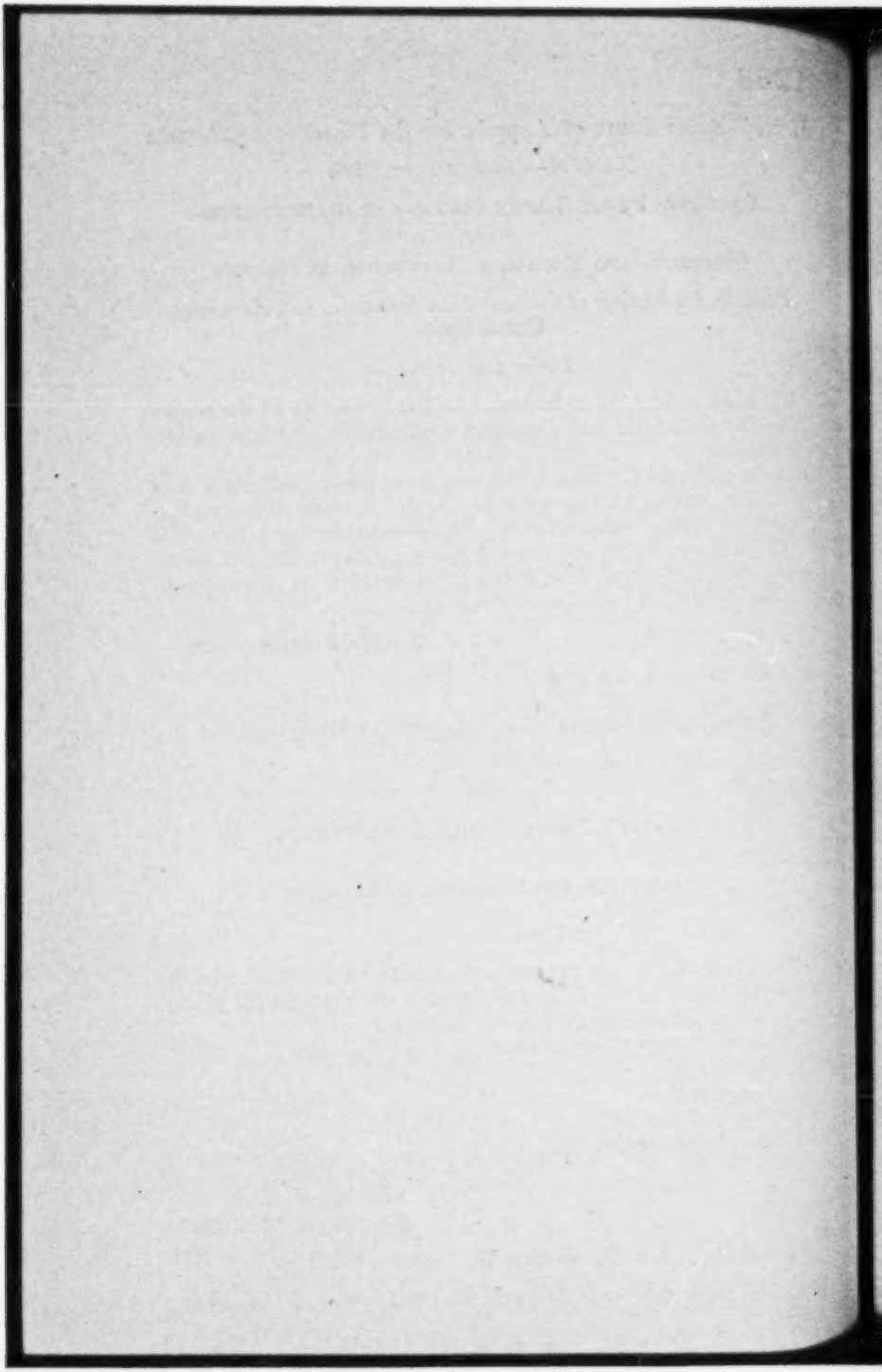
[Filed Dec. 18, 1943. Joseph W. Stewart, Clerk.]

United States Court of Appeals for the District of Columbia

I, Joseph W. Stewart, Clerk of the United States Court of Appeals for the District of Columbia, hereby certify that the foregoing pages numbered from 1 to 1233, both inclusive, constitute a true copy of the appendices to the briefs of petitioners and respondent, and the proceedings of the said Court of Appeals as designated by counsel for respondent in the case of: Engineers Public Service Company et al., Petitioners, vs. Securities and Exchange Commission, Respondent, No. 8394, October Term, 1943, as the same remain upon the files and records of said Court of Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of said Court of Appeals, at the City of Washington, this twenty-first day of December, A. D. 1943.

[SEAL] JOSEPH W. STEWART,
Clerk of the United States Court of Appeals
for the District of Columbia.



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Supreme Court of the United States

No. 15, October Term, 1944

Order allowing certiorari

Filed June 5, 1944

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Supreme Court of the United States

No. 16, October Term, 1944.

Order allowing certiorari

Filed June 5, 1944

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

In the Supreme Court of the United States

October Term, 1944

No. 15

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

ENGINEERS PUBLIC SERVICE COMPANY, ET AL.

No. 16

ENGINEERS PUBLIC SERVICE COMPANY, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

Stipulation

(Filed July 18, 1944)

Subject to the Court's approval, it is hereby stipulated and agreed by the attorneys for the respective parties hereto that for purposes of the hearing on the writs of certiorari in the above cases the printed record shall consist of the printed record designated as such for purposes of the petitions for certiorari.

It is further agreed that the parties may refer in briefs and argument to portions of the original transcript of record filed with the Supreme Court of the United States and not included in the printed record as herein designated.

CHARLES FAHY,
Charles Fahy,
Solicitor General.
WM. E. TUCKER,
T. JUSTIN MOORE,
PAUL D. MILLER,
GEORGE D. GIBSON,
Counsel for Respondents in No. 15 and Petitioners in No. 16.

Dated this 15th day of July 1944.

U. S. GOVERNMENT PRINTING OFFICE: 1944

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